

Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

In the matter of:

The Digital Performance
Right in Sound Recordings | Docket No.
and Ephemeral Recordings || 2005-1 CRB DTRA
(Webcasting Rate
Adjustment Proceeding)

Volume 10

Room LM-414
Library of Congress
First and Independence Ave., S.E.
Washington, D.C. 20540

Tuesday,
May 16, 2006

The above-entitled matter came on for
hearing, pursuant to notice, at 9:30 a.m.

BEFORE:

THE HONORABLE JAMES SLEDGE, Chief Judge
THE HONORABLE WILLIAM J. ROBERTS, JR., Judge
THE HONORABLE STAN WISNIEWSKI, Judge

APPEARANCES

On Behalf of Sound Exchange

DAVID A. HANDZO, ESQ
JARED O. FREEDMAN, ESQ
PAUL M. SMITH, ESQ
Jenner & Block
601 Thirteenth Street, N.W.
Suite 1200 South
Washington, D.C. 20005
(202) 639-6060
dhandzo@jenner.com

GARY R. GREENSTEIN, ESQ
General Counsel
SoundExchange
1330 Connecticut Avenue, N.W.
Suite 330
Washington, D.C. 20036
(202) 828-0126
greenstein@soundexchange.com

On Behalf of National Public Radio
Inc. (NPR), NPR Member Stations, CPB-
Qualified Public Radio Stations

DENISE B. LEARY, ESQ
635 Massachusetts Ave., NW
Washington DC 20001
202.513.2049
dleary@npr.org
(202) 513-2049

On Behalf of Collegiate Broadcasters
Inc. (CBI)

WILL ROBEDEE
6100 South Main Street
MS-529
Houston TX 77005
(713) 348-2935
willr@ktru.org

On Behalf of Royalty Logic, Inc.

KENNETH D. FREUNDLICH, ESQ.
Schleimer & Freundlich, LLP
9100 Wilshire Boulevard
Suite 615 - East Tower
Beverly Hills, California 90212
(310) 273-9807
kfreundlich@earthlink.com

On Behalf of Intercollegiate
Broadcasting System Inc., Harvard Radio
Broadcasting Co. Inc.

WILLIAM MALONE, ESQ
Miller & Van Eaton PLLC
1155 Connecticut Ave., NW
#1000
Washington DC 20036-4306
202.785.0600
wmalone@millervaneaton.com

On Behalf of Digital Media Assoc.
(DiMA), AOL, Live365, Microsoft Corp.,
Yahoo! Inc., National Public Radio

KENNETH L. STEINTHAL, ESQ
Weil Gotshal & Manges LLP
201 Redwood Shores Parkway
Redwood Shores CA 94065
(650) 802-3100
kenneth.steintal@weil.com

KRISTIN KING BROWN, ESQ
Weil Gotshal & Manges
1300 Eye Street, N.W.
Suite 900
Washington, D.C. 20005
(202) 682-7024

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

On Behalf of AccuRadio, Discombobulated LLC,
Digitally Imported Inc., myradio.com LLC,
Radioio.com LLC, Radio Paradise Inc., 3WK
LLC, Educational Media Foundation

DAVID D. OXENFORD, ESQ
Davis Wright Tremaine LLP
1500 K Street, N.W., Suite 450
Washington DC 20005
202.508.6656
davidoxenford@dwtr.com

On Behalf of The National Religious
Broadcasters Noncommercial Music License
Committee, Bonneville International Corp.,
Clear Channel Communications Inc., Salem
Communications Corp., Susquehanna Radio
Corp., The National Religious Broadcasters
Music License Committee

BRUCE G. JOSEPH, ESQ
KARYN ABLIN, ESQ
MATT ASTLE, ESQ
MARGARET RYAN, ESQ
SETH WOOD, ESQ
Wiley Rein & Fielding
1776 K Street, N.W.
Washington, D.C. 20006
(202) 719-4913
bjoseph@wrf.com

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

I-N-D-E-X

WITNESS: DIRECT CROSS REDIRECT RECROSS

Pelcovits

By Mr. Steinthal 6 251/277

By Mr. Handzo 232

EXHIBITS

<u>NO.</u>	<u>DESCRIPTION</u>	<u>MARK</u>	<u>RECD</u>
51	EC Decision on Sony-BMG merger		160
60	Belinfante and Davis article "Estimating the Demand for Record Albums"	34	35
61	Bate-Stamped SX113974-113978	37	
62	<u>Arbitron</u> Report "Internet 9: The Media and Entertainment World of Online Consumers"	57	58
63	Attachment A to Pelcovits' Written Testimony	127	129
64	DOJ/FTC Horizontal Merger Guidelines	151	
65	Universal Music Group PowerPoints	153	
66	FTC Document	157	159
67	FTC Document	157	159
68	FTC Document	158	159
69	FTC Document, Commissioner Thompson	158	
70	Manning and Reed Article	161	162
71	FTC Commissioners Statement in the <u>Matter of Sony Music Entertainment et al</u> , C-3971 through 3975	163	
72	Pelcovits Deposition	176	
SX 276 DP	Excerpt from Roback Transcript	235	

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

P-R-O-C-E-E-D-I-N-G-S

9:35 a.m.

CHIEF JUDGE SLEDGE: Good morning.

We'll come to order.

Mr. Steinthal?

MR. STEINTHAL: Thank you, Your
Honor.

CROSS-EXAMINATION (CONT'D)

BY MR. STEINTHAL:

Q Good morning, Dr. Pelcovits. How
are you?

A Good morning, Mr. Steinthal.

Q We picked up just for a moment
where we left off yesterday on the issue of
non-subscription statutory licensed webcasters
versus subscription webcasters for a minute.

I'd like you to assume, for
purposes of my question, that 75 to 90 percent
of the universe of unique listeners to
statutory licensed webcasting are non-
subscription webcasters -- listen to non-
subscription webcasters. Okay?

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 And assume as well that a
2 substantial majority of that universe is not
3 and never will be willing to pay for radio.
4 Okay?

5 A Yes.

6 Q Now, you currently make no
7 allowance in your model for the demand
8 represented by those consumers. Correct?

9 A Not explicitly, no.

10 Q And I think you testified
11 yesterday that for purposes of your model, you
12 assumed that all the demand was represented by
13 the higher value users, who are subscription
14 users of statutory licensed webcasting.
15 Correct?

16 A I wouldn't say I assumed it but I
17 calibrated the model and the estimate of value
18 from the subscription customers, yes.

19 Q And not taking into consideration
20 that non-subscription universe. Correct?

21 A I just repeat the answer I just
22 gave you, which is, I calibrated it that way

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 and I think I explained the reasons why I
2 believe it should apply across the board.

3 Q Well, you stated yesterday that
4 one reason that you did not consider non-
5 subscription users was concerns over the non-
6 subscription or low value users cannibalizing
7 the subscription service market. Correct?

8 A Well, other than the word
9 consider. I did consider them but the reason
10 I did not try to -- one of the reasons I did
11 not try to separately value those customers
12 was because of concerns over cannibalization,
13 that's correct.

14 Q Did you do any study or analysis
15 of the extent to which non-subscription web-
16 cast users currently do or would, in the
17 future, cannibalize subscription statutory
18 licensed webcasting?

19 A No, I did not. Let me just add,
20 in order to really to that you'd need sort of
21 an experiment of changing prices for the
22 statutory license and see how the market

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 reacts. So, I didn't.

2 Q Now also yesterday, on your direct
3 testimony in the morning, I believe you
4 testified that, in connection with why you
5 weren't going to make an allowance for non-
6 subscription statutory licensed webcast
7 listeners, you made an analogy to the motion
8 picture market, did you not?

9 A Well again, I don't use the word
10 didn't make an allowance for, but I did make
11 an analogy to the motion picture industry
12 where for purposes of explaining that, there
13 could be a value to using a form of media in
14 an advertiser supported forum that could
15 potentially cannibalize the revenues from a
16 subscription.

17 Q Well it's true, is it not, that
18 movie copyright owners license their content
19 both in theatrical release markets and the
20 advertiser supported free television market.
21 Correct?

22 A They do but not at the same time

1 and it depends on the show. So, yes, they do
2 and they do under their own estimate of how to
3 make profits in their business.

4 Q Wouldn't you agree that any
5 complete economic analysis of the motion
6 picture business would have to take into
7 consideration the various revenue streams of
8 motion pictures, including theatrical release,
9 home video, pay per view, and advertiser
10 supported free TV?

11 A My answer is it depends on what it
12 is that you're analyzing. I would say and, if
13 we're going to draw this analogy, that if the
14 Court here were setting rates for motion
15 picture copyrights and they were to compel the
16 motion picture industry to base its rates for
17 per view off of the advertising paid when a
18 motion picture finally reaches the broadcast
19 TV, they would be under-valuing the value of
20 that copyright.

21 Q But the reality is that in the
22 motion picture industry it's true, is it not,

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 that motion picture copyright owners derive
2 different levels of compensation on a per use
3 or per view basis comparing theatrical release
4 to home video release to advertiser supported
5 television, don't they?

6 A Yes.

7 Q And they get a heck of a lot more
8 in a theatrical release market per view than
9 they do in the advertiser supported free TV
10 market, don't they?

11 A They do and add in a very
12 important part of their revenue stream, which
13 is DVDs.

14 Q And that comes in in the middle.
15 Right? I mean, you pay roughly \$4 per view
16 for a DVD compared to \$10 per view for a
17 theatrical motion picture. Right?

18 A What's interesting is that they're
19 getting that 50 percent of the ticket price in
20 a movie theater and 50 percent of the price in
21 a DVD rental.

22 Q And the advertiser supported

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 thing, the advertiser supported per view
2 analysis would be a fraction, wouldn't it?

3 A I don't know. I've never seen it
4 expressed as a percentage.

5 Q Now I believe you testified on
6 your direct yesterday, and it's on page 32 of
7 your written testimony as well, you assume for
8 your model, do you not, that the ratio of the
9 consumer price for a subscription music
10 service to the sound recording royalty rate
11 would be the same in both your benchmark
12 market and your target market. Correct?

13 A Yes.

14 Q And that's a key assumption in
15 your analysis?

16 A It is.

17 Q And you base this assumption on
18 your opinion, and this is also on page 32, I
19 believe, that the demand elasticity in both
20 the target market and the benchmark market
21 will be very similar, if not the same.
22 Correct?

1 A Yes.

2 Q And that's based on your
3 comparison, your analysis of the comparison
4 between the benchmark market and the target
5 market. Correct?

6 A It's based on the fact that that
7 these are very similar markets, similar types
8 of consumers and also based on general
9 knowledge of elasticity estimates and pricing
10 practices in a variety of industries.

11 Q But I believe you also testified,
12 based on your conclusion that the supply and
13 demand characteristics in both markets are
14 comparable. Correct?

15 A I didn't say comparable. I think
16 I already just said what I said, which is they
17 have similar buyers and similar sellers.
18 They're very similar markets.

19 Q But there were no differences you
20 identified in that respect that would change
21 your opinion with respect to the elasticity
22 issue. Right?

1 A I felt that it was a reasonable
2 assumption that the elasticities were similar
3 and that they were close enough to apply the
4 same percentage in the two markets. I cannot
5 say they are exactly the same. It could be
6 somewhat higher, it could be somewhat lower.
7 It would yield, in my opinion, a result that
8 would be at or close to the one that I
9 recommend.

10 Q Now your model, looking at page 34
11 of your statement, also assumes, does it not,
12 that any change in the copyright fees can be
13 passed on dollar for dollar to consumers in
14 both the benchmark and the target markets.
15 Correct?

16 A In this model, that's correct.

17 Q And when you're talking about
18 copyright fees, you're talking about the sound
19 recording copyright fees. Correct?

20 A Correct.

21 Q And that's the normal assumption
22 in a competitive market with constant average

1 and marginal costs, is it not?

2 A Yes.

3 Q But as you testified yesterday,
4 you took this market as it is, without any
5 analysis of whether it's a competitive market.
6 Correct?

7 A I used a competitive market model
8 for purposes of estimating and recommending a
9 rate, that's correct.

10 Q Now, did you do any analysis,
11 going back to the question of whether your
12 assumption that in the target market or the
13 benchmark market, the copyright fees could be
14 passed through to consumers dollar by dollar,
15 did you do any analysis of either the target
16 market or the benchmark market to determine in
17 fact whether statutory licensed webcasting
18 services, for example, would be able to pass
19 off, dollar for dollar, increases in sound
20 recording royalty costs?

21 A I studied the industry. I looked
22 at the rapid evolution and entry of many firms

1 into the industry and it's my belief that in
2 an industry where you see entry taking place
3 relatively easily, the competitive model is a
4 reasonable model used.

5 Q Let me pause right there. This
6 notion of rapid entry into the industry, it's
7 true, is it not, sir, that the number of
8 entities engaging in statutory licensed
9 webcasting has shrunk substantially since
10 2001? Is it not?

11 A I don't know if that's true, but I
12 know there are many firms that have entered
13 and built new business models in this industry
14 that are brand new and there seemed, from
15 everything I studied, to be no major barriers
16 to entry.

17 Q Name one entity, sir, that entered
18 the market for statutory licensed webcasting
19 since 2001.

20 A As far as I know, I think Live365
21 is a, if it's not brand new, it's entire
22 breadth and operation in the market has

1 developed significantly in the last few years.
2 I think the entire market has grown quite a
3 lot in the last few years.

4 Q Let's talk about your testimony
5 just this morning --

6 A Right.

7 Q -- about entry into the market.
8 Live365 I will represent to you participated
9 in the CARP in 2001. They've been around for
10 a while. Can you name any entity, any entity,
11 that has come into the market for statutory
12 licensed webcasting since the initial CARP
13 rate was set in 2002?

14 A I think that any broadcaster, any
15 channel, that has come into the market is
16 brand new. Live365 has, and constantly
17 advertises, it has thousands and thousands of
18 channels, many of them brought to the market
19 by very small entities. Anytime you have
20 someone who decides to become a webcaster and
21 use the Live365 platform, they are a new
22 entrant into the market. They are providing

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 the music to customers. There is, the same
2 thing is true of the thousands of channels
3 that are being broadcast to the Rhapsody
4 customers on Radio Pass. Radio Pass has, I
5 believe, over 3,000 channels.

6 So, I believe any time there is a
7 new webcaster, regardless of exactly the
8 mechanism by which the webcaster delivers a
9 service to the customer, that is entry.

10 Q Sir, are you suggesting that an
11 individual hobbyist that pays \$10 a month to
12 Live365 or whatever it is, to get its signal
13 delivered through Live365 is comparable in
14 circumstances to the statutory licensed
15 circumstances of AOL or Microsoft or Yahoo?

16 A It is an entrant that leads to the
17 disciplining of prices. And it's the
18 disciplining of prices that's the hallmark of
19 a competitive model. In other words, if there
20 is an inferior product or too high priced a
21 product, then other people can come in and
22 provide the music. It is very easy to lease

1 capacity band width from Live365 and get on
2 the air. And if you do that, --

3 Q Sir --

4 A -- I'm sorry, let me complete my
5 answer. And if you do that, in my mind,
6 you're an entrant into this market. You can
7 be a webcaster. There are many radio stations
8 that are coming online all the time. They are
9 being rebroadcast through subscription
10 channels. So, in my mind, that is and does
11 constitute competitive entry.

12 Q Now could you answer my question?
13 Do you view an individual hobbyist who puts
14 his channel up on Live365 as comparable in
15 circumstance economically to AOL, Yahoo, or
16 Microsoft operating their statutory licensed
17 webcasting operations under this license?

18 A They are no comparable. They are
19 a competitive factor and they are there to
20 discipline the market.

21 Q And how do they discipline the
22 market for the licensing of sound recording

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 performance rights under the compulsory
2 license when they don't pay the sound
3 recording compulsory license fees?

4 A I'm talking about competition in
5 the market for the delivery and the
6 copyrighted music to the customer, not in
7 terms of the SoundExchange copyright fee.
8 That's set by the -- was set by the CARP, will
9 be set by this Court.

10 Q Are you familiar with the fact
11 that the individual broadcasters or hobbyists
12 whose channels are aggregated by Live365 don't
13 pay the sound recording royalty Live365 does?

14 A They pay to Live365 fees that
15 Live365 then pays to SoundExchange.

16 Q So the answer is yes, you are
17 familiar with the fact that they don't worry
18 about paying the sound recording royalty fee,
19 they look at what the Live365 fee is to them
20 for getting their channel up. Right?

21 A That doesn't mean they don't worry
22 about what the rate is because the rate flows

1 through to what they have to pay and that then
2 affects the behavior of competition in the
3 marketplace. It doesn't matter who, whether
4 there's an intermediary that you write the
5 check to, there's still competition in the
6 marketplace.

7 Q Let's go back to your testimony
8 just this morning, under oath, about the rapid
9 entry into the market. You've cited
10 individual hobbyists or broadcasters that get
11 their channels up on Live365. Can you name
12 one other company since 2001 that ha launched
13 and entered into the statutory licensed
14 webcasting market?

15 A My regression had a list of 30
16 services. Do I -- they included Radio IO,
17 Digital Imported, GotRadio, 3WK, Ultimate 80s,
18 Cross Walk, WOLF FM, Howling Oldies and Super
19 70s. Do I know when they actually entered the
20 market? No.

21 Q And even if you knew that they had
22 entered the market before or after, would you

1 compare any of the economic circumstances of
2 those entities that you just mentioned, to
3 AOL, Yahoo, or Microsoft?

4 A They are different companies.
5 They are going to be different. That doesn't
6 mean there are not competitive factors in the
7 market.

8 Q Just so it's clear, even though
9 you've testified that there's been rapid entry
10 into the market, you can't identify as a
11 matter of fact that has entered the market
12 under the prior CARP rate. Correct?

13 MR. HANDZO: Objection. That
14 misstates his testimony.

15 CHIEF JUDGE SLEDGE: Sustained.

16 BY MR. STEINTHAL:

17 Q Can you identify anybody, as a
18 matter of fact?

19 MR. HANDZO: Objection. Asked and
20 answered.

21 CHIEF JUDGE SLEDGE: I assume the
22 question is other than the ones you've already

1 identified?

2 MR. STEINTHAL: Other -- yes.

3 BY MR. STEINTHAL:

4 Q Other than the ones you've already
5 identified? Fair enough.

6 A Can I identify when they've
7 entered? No. There has been quite a lot of
8 firms entering into this market, which is a
9 very new market.

10 Q And on what do you base your
11 testimony that quite a lot of firms have been
12 entering the market?

13 A On my list of firms and research
14 that was done on who is in the market, how
15 many are in the market, and my knowledge that
16 this business as a whole, as a subscription
17 business, has been developing very rapidly
18 over the last several years. It's essentially
19 something that's discussed in virtually
20 anything you read about the industry.

21 Q When you say subscription
22 business, are you talking about your target

1 market, your benchmark market or both?

2 A I was talking about the target
3 market. That's what the -- in order to sort
4 of apply this competitive model, I'm assuming
5 that this is the case in both markets.

6 Q And about this rapid entry. Are
7 you familiar with the filings in the copyright
8 office indicating the number of entities that
9 are making, excuse me, the number of entities
10 that are availing themselves of the statutory
11 license under Section 114?

12 A I don't know of the filings. I do
13 know who has paid SoundExchange.

14 Q Well, are you familiar with the
15 fact that if you look at the number of
16 entities actually availing themselves of a
17 Section 114 compulsory license, that number
18 has dropped precipitously since 2001?

19 A I don't know that it would not be
20 consistent with what I've seen from who is
21 paying SoundExchange in the last three years.
22 I don't know about 2001. In my mind, that's

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 very, that's ancient history in this business,
2 given the rapid development. So, I think the
3 fact that there have been a large number of
4 firms, a large number of active firms, no
5 obvious barriers to entry, says in my mind,
6 that it's reasonable to model this as a
7 competitive industry.

8 JUDGE WISNIEWSKI: Excuse me, just
9 for a second. Could you identify for the
10 record where you were reading from in terms of
11 the list of firms used in your regression?

12 THE WITNESS: Yes, Judge. This is
13 just a list, a table that I constructed of the
14 non-interactive services used in the
15 regression, so it's among the different
16 documents that we've prepared and provided in
17 the case. I don't believe --

18 JUDGE WISNIEWSKI: Is there a tab
19 that it was --

20 THE WITNESS: This is not part of
21 the testimony.

22 JUDGE WISNIEWSKI: Oh, okay.

1 Sorry.

2 MR. STEINTHAL: I actually was
3 going to mark it as an exhibit shortly, Your
4 Honor, so you can see it.

5 JUDGE WISNIEWSKI: Oh, okay.
6 Thank you.

7 BY MR. STEINTHAL:

8 Q Now again, on the subject of the
9 ability to pass along any increase in the
10 royalty rate, dollar for dollar, to the
11 consumer, you testified that, you know, what
12 you did or didn't do with respect to that
13 conclusion. Are you familiar with the fact
14 that the online music industry still faces
15 competition in terms of consumers from free
16 services, such as Kazaa, and eDunky, and other
17 file sharing services?

18 A I would say that there might be
19 some competition for how the consumer spends
20 his or her dollar on music, as a whole, but
21 those are services which, as you said, are
22 file transfers. So, they become downloads and

1 illegal downloads.

2 Q Well, you're familiar with the
3 fact that a lot of activity goes on by users
4 using those services in obtaining music, are
5 you not?

6 A Absolutely. There is still a lot
7 of piracy taking place. I agree with that.

8 Q Did you take into consideration in
9 your assumption that digital music services
10 could pass along, dollar for dollar, increases
11 in sound recording royalties, the competitive
12 impact in pricing by virtue of the existence
13 of those services?

14 A I think yes. I think I took
15 account of that. That's exactly the nature
16 of, when I talk about a competitive model,
17 the availability of substitute, the legal or
18 illegal effect, what the demand curve looks
19 like, they don't affect the general behavior
20 of firms in a competitive market. It's -- let
21 me just explain something.

22 You were trying to say that

1 competition means you can't pass all of your
2 costs along. Competition is what requires
3 firms and forces firms to essentially price
4 based on cost. And as cost changes, price
5 changes.

6 Q But sir, you assumed, you said it
7 this morning, that in your target market and
8 in your benchmark market, any increase in the
9 sound recording royalty cost could be passed
10 along, dollar for dollar, to the consumer.
11 Right? Are you with me so far?

12 A I said that that's the way in
13 which I analytically structured the model.
14 Yes, I used a competitive industry model.
15 Correct.

16 Q Now, what I'm asking you is
17 whether, in making that assumption, it's a
18 valid assumption if in fact, because of the
19 existence of these free services, digital
20 music companies don't feel as if they can pass
21 on all their costs, dollar for dollar, to the
22 consumer?

1 A That's an absolutely valid
2 assumption. What you're talking about is how
3 much demand will change if costs are passed
4 along. You're also talking about some things
5 which would affect market equilibrium in the
6 shorter run, rather than what happens when an
7 industry shakes and the affects of costs
8 changes alter the nature and the type of
9 things being provided. But cost increases get
10 passed along in a competitive industry, cost
11 decreases get passed along in a competitive
12 industry. These are not perfect models
13 because there's a lot of complexity but as a
14 working hypothesis and a working model, I
15 modeled this as a competitive market. I also
16 modeled it and experimented with this as a
17 oligopolistic model. And it's a ver complex
18 set of models, but it would not change my
19 underlying conclusions.

20 Q Well, let me ask you this. Did
21 you consider whether some of the prices that
22 are currently being offered in your benchmark

1 market are lower than they ultimately will be
2 because firms are deliberately pricing their
3 products at a low price point to try to build
4 demand for those new music services precisely
5 to compete with the free Kazaas and the
6 eDunkys and the Groksters?

7 A They might be doing that just as
8 the target market companies might be doing
9 that. And there is certainly a lot of market
10 building that's going on. But in terms of
11 what prices are now indicating something to us
12 about consumer value in the market, the prices
13 are what they are.

14 Q But hypothetically, if in fact
15 your benchmark market companies are pricing
16 deliberately at a price point lower than what
17 they expect the price to be to build demand
18 for the product at a time when there are still
19 free services offering file sharing, you'd
20 agree with me, wouldn't you, that if the price
21 in your benchmark market is under what it
22 economically normally would be, then your

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 model doesn't capture that difference between
2 the current under-market price and what the
3 market price ultimately will be. Right?

4 A It doesn't capture it. I don't
5 know what that does to the application of the
6 benchmark. That would depend on a lot of
7 different factors. I, frankly, haven't worked
8 through all of them.

9 Q So you didn't -- let me ask you
10 this. Hypothetically, if in fact companies
11 engaged in your benchmark market have done a
12 short-term price campaign to build demand and
13 a year from now the prices in your benchmark
14 market were 50 percent higher than they
15 currently are as they settle in in a corrected
16 mode, then you would have a different result
17 from your model. Right?

18 A We'd have a different result from
19 both the standpoint of the music service and
20 from the standpoint of the music companies.
21 The -- if we look at the percent of revenue
22 fee charged in my benchmark market, that's

1 tended to stay in the same range, 40 to 50
2 percent, for quite a long time, and it's
3 applied to services that have a range of
4 different retail prices, though it seems to me
5 as if the basic conclusion that the copyright
6 fees in that range of percent of revenue seems
7 to be pretty robust.

8 Q Let me put up one of these charts,
9 so I can make this question a little bit more
10 precise.

11 For instance, SoundExchange's demo
12 52. And you calculate, and we'll come back to
13 this in a little bit, but you calculate the
14 difference between what you call the target
15 market, non-interactive webcaster, and the
16 benchmark market, interactive service, and
17 that's the line three on each of your four
18 examples. Right?

19 A Yes.

20 Q So, if it turns out that the
21 pricing in the benchmark market is
22 deliberately at a under-market number now to

1 build demand, and that in fact the market
2 price, once it settles, for example 150
3 percent or 200 percent of the numbers you have
4 in your line two, then the ratio is going to
5 shrink. Correct?

6 A The ratio would shrink, assuming
7 that the same type of thing is not going on in
8 the target market, there is not the same
9 effort by the same type of companies to build
10 their business in those markets.

11 Q Now I believe you relied, in your
12 testimony, on the elasticity of demand
13 assumption that I asked you about a few
14 moments ago, on an article by Alexander
15 Belinfante. Right?

16 A That is the article that I relied
17 on, but not for that assumption.

18 Q What did you rely on it for?

19 A I relied on it as one of the
20 things, one of the pieces of evidence that the
21 demand elasticity for an individual CD is very
22 low.

1 Q Okay. And that study related to
2 demand elasticity as between individual CDs
3 not as between online music services.
4 Correct?

5 A Between or for online music
6 service, yes.

7 Q Indeed, the study was conducted in
8 1977, was it not?

9 A The study was conducted in 1977.
10 It's the only article that I am aware of and
11 I talked to Dr. Belinfante, that he's aware
12 of, that's conducted such an estimate.

13 Q Let me ask you to take a look at
14 Services Exhibit 60. It's the Belinfante
15 article.
16 And can you identify this as the Belinfante
17 article upon which you relied?

18 A Upon which I relied? Yes.

19 (Whereupon, the document
20 referred to as Services
21 Exhibit No. 60 was marked
22 for identification.)

1 MR. STEINTHAL: I would offer
2 Services Exhibit 60 into evidence.

3 CHIEF JUDGE SLEDGE: Any objection
4 to the Exhibit?

5 MR. HANDZO: No objection.

6 CHIEF JUDGE SLEDGE: Without
7 objection, Exhibit 60 is admitted.

8 (Whereupon, the document
9 marked as Services
10 Exhibit No. 60 for
11 identification was
12 received into evidence.)

13 BY MR. STEINTHAL:

14 Q Take a look, if you would, at
15 page, the third page of the document. That
16 would be page 59, if you look in the upper
17 left-hand corner of the book or periodical
18 from which it was obtained.

19 A Now, there's a 49. There's a
20 third sheet, the upper left-hand corner shows
21 a 50.

22 Q All right. I thought it was 59.

1 50, okay. It's my eyes. Sorry. Only my
2 eyes. It's the first thing to go.

3 A There's a paragraph on the bottom
4 left of this page. It reads, as expected, the
5 variable introduced to measure taste, QS,
6 proved to be the most significant one in the
7 model, as is shown by its T value. This also
8 indicates the importance of the use of singles
9 as a way of promoting the sales of an album.
10 The second most significant variable was RC,
11 revealing the importance of radio play and
12 live concerts in giving exposure to a record.

13 Do you have any reason to dispute
14 the validity of that finding?

15 A Not for the purposes and
16 interpretation of the equation as given by the
17 authors.

18 Q By the way when you testified
19 earlier that your regression analysis had a 90
20 some-odd percent confidence level, that
21 assumes your inputs and assumptions underlying
22 the model are correct. Is it not?

1 A It assumes that the -- yes, it
2 assumes quite that it's a meaningful
3 regression and that the data is accurate and
4 I've captured and specified the
5 equation properly. I agree.

6 Q All right. Let's go to the
7 regression, if we can. Let's take a look at
8 the document that you're referring to and see
9 whether I've got the right document. Copy for
10 the bench so they can see it.

11 Marked as Services Exhibit 61 is a
12 document bearing Bate-stamped number SX113974
13 through 113978.

14 Is this the document you referred
15 to earlier as the document containing the
16 inputs in your regression analysis?

17 A Yes, it is.

18 (Whereupon, the document
19 referred to as Services
20 Exhibit No. 61 was
21 marked
22 for identification.)

1 BY MR. STEINTHAL:

2 Q Now, turn to the first page, if
3 you would. The first couple of pages
4 represent the universe of services you looked
5 at in conducting your regression. Is that
6 right?

7 A They are the inputs. Those are
8 the universe, the population, yes.

9 Q And this represented the
10 subscription services that were broadly
11 available for purposes of your regression
12 analysis. Correct?

13 A Yes.

14 Q First of all, I want to make sure
15 we understand each other when we talk about
16 what is statutory licensed webcasting service
17 for purposes of your target market and what
18 isn't.

19 In your written testimony on pages
20 7 to 8 you said, in reference to what is non-
21 interactive webcasting in your target market,
22 --

1 A Right.

2 Q -- you state at the very bottom of
3 page 7, for purposes of this analysis, I have
4 presumed that non-interactive webcasting does
5 not permit any form of user input to customize
6 particular stations. Correct?

7 A Right.

8 Q So I gather, if a station or a
9 service was delivering internet radio that
10 incorporated artist preferences, you would
11 keep that out of your target market analysis?

12 A Well the target market means the
13 market that is eligible for the statutory
14 license. So, it would not be eligible for a
15 statutory license. It does not mean it would
16 not be in the regression. The regression
17 includes all subscription music services,
18 whether they're in or outside of the statutory
19 license.

20 Q Okay. But when you do your
21 comparison of values of target market
22 statutory licensed webcasters to interactive,

1 you would want to make sure that you were
2 comparing statutory license compliance
3 services to benchmark market services.
4 Correct?

5 A Ideally, I would. But I did
6 include in the regression some that are not
7 purely non-interactive. That would be true of
8 Launchcast Plus.

9 Q Well, let's take the ones right up
10 there on your 6.2. Launchcast Plus, you would
11 acknowledge, would you not, is deemed by the
12 recording industry to be not in compliance
13 with the statutory license. Right?

14 A Correct.

15 Q So, if you look at that \$3.99
16 figure that you use for purposes of the ration
17 in your modeling, that \$3.99 actually
18 overstates to some degree the value of a
19 statutory license service. Correct?

20 A Well, to some degree that I could
21 not measure, yes, I agree.

22 Q Now, Musicmatch Gold, do you know

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 how that service works?

2 A That also, I believe, has some
3 non-statutory features.

4 Q So again, that \$4.95 includes some
5 measure of value outside of the statutory
6 license that you were unable to measure.
7 Correct?

8 A Yes.

9 Q And Rhapsody Radio, isn't that a
10 service which enables you to put up to ten
11 artists into your desired preference streams
12 before you get into your stations?

13 A That I wasn't sure of. I had --
14 my understanding was that Rhapsody Radio was
15 a statutory service.

16 Q Well, can you tell us what in fact
17 the features of Rhapsody Radio are?

18 A The features are primarily, it's a
19 streaming, you know, a streaming service
20 similar to many other non-interactive services
21 in their basic characteristics, which is a
22 programed set of music that's delivered to the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 customer.

2 Q Well, do you know whether it has
3 skipping, for example?

4 A I believe it might, which I think
5 is sort of a controversial issue on which side
6 of the line skipping is. Is it non-
7 interactive or not? I understand that to be
8 an issue that is still not resolved.

9 Q Is it fair to say that as you sit
10 here today, you don't know whether Rhapsody
11 Radio includes certain consumer influence
12 features that the recording industry believes
13 can render it outside the statutory license?

14 A I don't recall.

15 Q All right, let's go to your --
16 Exhibit 61.

17 A Oh, okay.

18 Q Live365 VIP, that one's got the
19 big 10,000 station input factor. Those are
20 the -- that's because it's an aggregator. Is
21 that right?

22 A It is a service that provides more

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 than 10,000 stations. It's actually more than
2 10,000.

3 Q But it doesn't program them
4 themselves, it basically aggregates. I mean,
5 the vast majority of those 10,000 are
6 individual broadcasters or hobbyists whose
7 streams are aggregated and then delivered by
8 Live365. Correct?

9 A Yes.

10 Q Now, the entity here at 19 and 20,
11 DI Gold and DI Platinum, --

12 A Yes.

13 Q -- do you know what that stands
14 for, what the real name of the service is?

15 A I believe it's Digital
16 Interactive, but I don't --

17 Q Digitally Imported ring a bell?

18 A Oh, I think it does. Let me --
19 Digitally Imported, yes. Sorry.

20 Q Did you know that the price for
21 their subscription service, since the time you
22 did your regression analysis, has been dropped

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 to \$4.95 a month?

2 A I didn't. That actually would
3 improve my regression results.

4 Q Well, it would ultimately result
5 in lowering the average, would it not, of the
6 non-subscription services and thus increasing
7 the disparity between non-interactive services
8 -- I think I misspoke with the word non-
9 subscription. Let me rephrase it.

10 It's true, is it not that if price
11 was dropped to \$4.95, it would increase the
12 ratio between non-interactive services that
13 are under the statutory license and your
14 target market -- I mean, I'm sorry, and your
15 benchmark market. Correct?

16 A It might change the ratio, but
17 that doesn't tell you what the regression
18 would do. I ran regressions without Digitally
19 Imported, without some of the sort of small
20 services. And, in fact, if you look at -- I'd
21 have to check exactly what was in and outside
22 of this in the last page of the exhibit you

1 gave me.

2 That is a regression where I
3 dropped eight of the observations from the
4 sample. Let's see it says -- sorry -- seven
5 of the observations from the sample. You can
6 tell that by seeing under sort of the top of
7 the page, it says, there's a column that says
8 source and then there's DF. DF is degrees of
9 freedom and the degrees of freedom have fallen
10 here, so that means there are fewer
11 observations that are being used in the
12 regression.

13 And when I pull out some of the
14 smaller services, if you look farther down
15 under the regression results where the table
16 that says parameter estimates under the
17 variable for on-demand, the parameter estimate
18 is 0.55 and the one from the regression I use
19 in the testimony is 0.60. So, 0.55 says that
20 the interactive services are worth 55 percent
21 more, rather than 60 percent more.

22 Q Now, you didn't wait --

1 CHIEF JUDGE SLEDGE: Mr.
2 Steinthal, let me interrupt you just a minute.

3 Ten minutes ago, when you
4 testified about the passing along the cost to
5 the consumers and then you went into the same
6 question that has just been asked about the
7 affect of subscription prices to the ratio, I
8 got a little puzzled then and your last
9 question increased my confusion. So, let me
10 just see if I'm straightened out.

11 If the subscription price goes up,
12 what does that do to the ratio?

13 THE WITNESS: To the ratio of the
14 fee to price of the service, sir, Your Honor?

15 CHIEF JUDGE SLEDGE: Yes, this
16 ratio.

17 THE WITNESS: That would depend on
18 whether it's a statutory or non-statutory
19 service. If it's a statutory service, the fee
20 ratio would go down as the price goes up. If
21 it's a non-statutory service and there's a
22 percentage of revenue as part of the contract

1 and that is what governs what is paid, then it
2 would stay the same.

3 CHIEF JUDGE SLEDGE: And if the
4 ratio goes down, your recommended rate in your
5 model goes down?

6 THE WITNESS: The ratio goes down
7 in the benchmark market and that would be the
8 -- and that indeed is what was reflected in
9 the market and that is indeed what the overall
10 evidence would say. Yes, it would.

11 CHIEF JUDGE SLEDGE: Thank you.

12 BY MR. STEINTHAL:

13 Q Sir, in doing your regression, and
14 taking in the data from the companies listed
15 on Exhibit 61, you didn't weight the services
16 by any measure such as how frequently users
17 actually used one service against the other.
18 Correct?

19 A In the regression, I did not. But
20 I say that with respect to the overall result,
21 it doesn't seem to matter.

22 Q And if you turn to the flip side

1 of the first page, the second page, --

2 A We're on?

3 Q -- of your regression?

4 A The second page, sir?

5 Q Yes.

6 A Okay.

7 Q You included XM Radio Online. Is
8 that the satellite radio service that offers
9 several of its stations in an online
10 webcasting format?

11 A That's correct.

12 Q Now, let's see. On 6.2, we talked
13 about the issue with respect to Yahoos, Music
14 Matches, and Rhapsodies radio products. Let
15 me ask you about Radio Free Virgin and Virgin
16 Digital.

17 Are you familiar with the fact
18 that Virgin Digital is a product that is
19 primarily marketed in the UK and not in the
20 US?

21 A It is available if you -- it's
22 available in the US. That part -- that's what

1 I based this on. This is a service available
2 in the US. I don't know where else and how
3 it's marketed and I did not try to measure
4 where the marketing efforts are.

5 Q Would it surprise you to know that
6 there are less than 1,000 or approximately
7 1,000 Virgin Digital US subscribers?

8 A No.

9 Q Now, in doing your comparative
10 analysis to get the ratios that you used for
11 your model, you used the non-interactive
12 services as against the non-portable
13 interactive services. Right?

14 A Correct.

15 Q Now, are you familiar with the
16 fact, sir, that under the statutory license,
17 webcasters operating under the statutory
18 license can deliver their services and it
19 doesn't matter whether the consumer accesses
20 those streams on their computers or portable
21 devices that may be internet enabled?

22 A Yes.

1 Q And they pay the same rate, either
2 way. Correct?

3 A Yes.

4 Q Now, wouldn't it be more apples
5 and apples for purposes of calculating your
6 line three ratios to look at the prices for
7 the non-interactive statutory webcasters which
8 are able to deliver to portable devices as
9 compared to subscription interactive on-demand
10 services that are also able to deliver to
11 portable devices?

12 A If I wanted to, which I didn't,
13 come up with a rate that I said should apply
14 to both portable and non-portable as a
15 recommendation for a statutory rate, then I'd
16 want to use a blend of the portable and non-
17 portable services. I -- so, I think this is
18 a two-step process, rather than your question
19 implying I should have put them all together.

20 Q And if you had looked either at a
21 blended price for portable and non-portable or
22 just the portable interactive services, then

1 the ration would increase, wouldn't it?

2 A The ratio?

3 Q The line three ratio on 6.2?

4 A The ratio would decrease.

5 Q I'm sorry, the ratio would
6 decrease. You'd go from one to two, to one to
7 three, or one to four. Something like that,
8 right?

9 A Something like that.

10 Q And you actually have some of the
11 monthly prices for the portable services in
12 your other report. It's anywhere from \$11.99
13 to \$14.99, isn't it?

14 A I would, I would -- yes, I have
15 them. I could have done it that way. I could
16 have gotten a lower ratio there. I could have
17 then applied it to a larger consumer price and
18 also to then applied it to the rates being
19 paid by the, in the interactive contracts for
20 the portable services. So, all of the ratios
21 and all of the numbers would have been
22 different. This would have gone down. It

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 would have been applied to a larger number,
2 and that then would have been applied to a
3 larger number. And the number would have been
4 larger.

5 Q Sir, as I'm looking at attachment
6 Appendix 80, a written report, which is the 17
7 contracts that you used to calculate the
8 benchmark market subscription rate, --

9 A Right.

10 Q -- I just want to be sure I'm
11 getting this right. There are 5 of the 17
12 agreements upon which you rely go back to
13 2002, do they not?

14 A Yes. Let me just double check.
15 One, two, three, four -- one, two, three,
16 four, five. Yes.

17 Q And since the exhibit itself
18 doesn't show it -- hold on a second.

19 It's true, is it not, that if you
20 stratify the 17 agreements by entity that
21 actually negotiated with and entered into
22 licenses with the labels underlying this

1 appendix, if I do my math right, four are
2 MusicNet. Correct?

3 A One, two, three, -- one, two,
4 three -- yes.

5 Q And four are Musicmatch before it
6 was acquired by Yahoo?

7 A I'm not sure about the contract
8 from 10/15/04. I think the acquisition, the
9 close of the acquisition was in that month.
10 So, it could be right before or right after.

11 Q And the others are definitely
12 before?

13 A The others are before the
14 acquisition. I'm not sure if they're before
15 the announcement of the acquisition.

16 Q And four from Napster LLC?

17 A Four from -- one, two, three --
18 four from Napster, correct.

19 Q Two from Real Networks?

20 A Two from Real -- Rhapsody Real
21 Networks, yes.

22 Q And three from MusicNow. Correct?

1 A One, two, three from MusicNow. Or
2 did we say four? I didn't --

3 Q I said three from MusicNow.

4 A Okay. I got three. I was going
5 to have to go back if you said four.

6 Q And that was MusicNow before it
7 was acquired by AOL very recently. Correct?

8 A I believe so. I believe that's
9 correct, yes. The acquisition is --

10 Q Sir, turning to a different
11 subject, substitution and promotion for a
12 minute. Okay?

13 On page 51 of your statement, you
14 testify, do you not, that you have found no
15 empirical support for either position, meaning
16 the proposition that statutory licensed
17 webcasting is promotional of sound recording
18 sales or that it substitutes for sound
19 recording sales. Is that a fair statement?

20 A Again, this is all with respect to
21 the relative substitutability of non-
22 interactive and interactive. But that's what

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 I said with respect to that relationship.

2 Q Well, it's true that you found no
3 empirical support for the proposition that
4 statutory licensed webcasting substitutes for
5 sound recording sales. Correct?

6 A No. I said it provided no
7 empirical support that one was more than the
8 other. If you look at the beginning of the
9 paragraph, it says I have seen no evidence to
10 suggest there is any difference between these
11 two markets with respect to their promotional
12 or substitutional effects.

13 Q Well, did you find any empirical
14 evidence that in fact statutory licensed
15 webcasting substitutes for sound recording
16 sales?

17 A I did not.

18 Q And you looked for it, didn't you?

19 A I looked for evidence on
20 substitution in general. I didn't find any
21 measurements of substitution effects. In
22 particular, as I said, and the point I make in

1 my testimony which is what's relevant for my
2 modeling is whether there's a difference in
3 the substitution effects for the bench --
4 between the benchmark and the target market.

5 Q But you were looking for it in
6 both ways. You were looking for it and found
7 no empirical evidence of substitution.
8 Correct?

9 A I was looking something that would
10 let me compare the substitution effects in the
11 benchmark and the target markets. I found
12 nothing that would allow me to measure that
13 difference.

14 Q And you found nothing, just to be
15 precise, that enabled you to measure what
16 extent, if at all, statutory licensed
17 webcasting is in fact substitutional sound
18 recording sales. Correct?

19 A Nothing that would let me measure
20 it. That's correct.

21 Q Now, you testified yesterday that
22 your research materials included Arbitron

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 publications. Correct?

2 A Yes.

3 Q Let mark this as Services Exhibit
4 62, Arbitron Report entitled "Internet 9 The
5 Media and Entertainment World of Online
6 Consumers."

7 Is this, one of the Arbitron
8 reports of the nature that you reviewed in
9 connection with your research?

10 A Yes.

11 (Whereupon, the document
12 referred to as Services
13 Exhibit No. 62 was
14 marked
15 for identification.)

16 MR. STEINTHAL: I offer Exhibit 62
17 into evidence.

18 CHIEF JUDGE SLEDGE: Any objection
19 to Exhibit 62?

20 MR. HANDZO: Well, I would ask for
21 a further foundation. Mr. Steintal asked
22 whether it was of the nature that he reviewed.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 I would want to know whether this is one that
2 he reviewed before we go any further.

3 CHIEF JUDGE SLEDGE: Mr.
4 Steintal?

5 BY MR. STEINTAL:

6 Q Do you know whether this was or
7 wasn't one of the ones you reviewed?

8 A I believe it was, there were
9 several years worth of this study. So, I
10 believe I looked at this one. I might have
11 focused on the more recent ones. But I can't
12 say for 100 percent sure I looked at his
13 particular one. I looked at several of this
14 titled report of different vintages.

15 MR. HANDZO: No objection.

16 CHIEF JUDGE SLEDGE: Without
17 objection, Exhibit 62 is admitted.

18 (Whereupon, the document
19 marked as Services
20 Exhibit No. 62 for
21 identification was
22 received into evidence.)

1 BY MR. STEINTHAL:

2 Q On the second page of the
3 document, --

4 A Is that including the cover page
5 or not?

6 Q Yes. The overview.

7 A Okay.

8 Q It says welcome to the Ninth
9 Arbitron Edison Media Research Study of
10 Consumers Use of Streaming Media and the
11 Internet with brand new data from interviews
12 conducted in July 2002. We have conducted
13 these studies every six months since August of
14 1998 and our semi-annual reports have become
15 widely used sources of information on
16 streaming media and consumer behavior on the
17 internet. Is that consistent with your
18 understanding of how the Arbitron reports are
19 generally used in the industry?

20 A In terms of how they're used, it
21 says they are widely used. It doesn't tell
22 you how they're used. And I don't think

1 Arbitron would know, necessarily what everyone
2 uses them for.

3 Q But they are widely distributed
4 and used, to your knowledge?

5 A To my knowledge, they are.

6 Q Take a look, if you would, at page
7 14, paragraph 25. People who stream
8 frequently buy significantly more CDs than
9 most Americans. Some have mistakenly equated
10 the rise of streaming audio with a decrease in
11 record purchases. However, the data show that
12 the more streamers (those streaming in the
13 last month and last week) were also the group
14 that purchased the greatest number of CDs in
15 the past year. The average American purchased
16 13 CDs in the past year, while those that have
17 ever streamed have purchased 15 CDs. Monthly
18 streamers report that they bought an average
19 18 CDs and weekly streamers say they have
20 purchased nearly 21 CDs in the past year.

21 Did you make any reference to this
22 particular finding in the Arbitron reports in

1 connection with your research?

2 A I did review this and I think
3 there's a later one that gives somewhat
4 different data. But I did look at this. I
5 did take account of it. And I can tell you
6 why it does not tell me anything that I could
7 use to quantify what I want to quantify. And
8 there are two reasons for that. One is, it
9 says streamees. It's not clear whether this
10 is interactive or non-interactive streamees.
11 There was nothing in the report that let me
12 come to a conclusion on that. So, it doesn't
13 help at all.

14 Secondly, even to the extent a
15 report would survey customers who are
16 streamees of a particular type and compare
17 them to other customers. It does not tell you
18 -- those can be two different types of
19 customers.

20 Suppose it were true that, just to
21 take an example, high income people buy more
22 CDs and it's also true that high income people

1 tend to be streamees. Then all you've found
2 is the correlation between the two, you
3 haven't found the fact that streaming is what
4 itself leads to more or fewer purchases of
5 CDs.

6 Q Sir, this report was done in 2002.
7 Right?

8 A Yes.

9 Q Do you know how many, if any, of
10 your benchmark market services were actually
11 operating in 2002?

12 A I don't know.

13 Q Would it surprise you to know that
14 the earliest licenses that were secured were
15 in 2001 and then in 2002? And that these
16 services didn't launch commercially available
17 interactive streaming and on-demand services
18 until after the Arbitron report?

19 A I didn't know that.

20 Q Would that affect the conclusion?

21 A That would affect the issue of
22 whether this report could be used to just deal

1 with streamers. I would still be very
2 hesitant to draw any conclusion about
3 different types of streamers, whether they're
4 interactive or non-interactive based on a 2002
5 report.

6 And, finally, and I can say this
7 again very firmly, it is very important when
8 you're doing surveys to try to evaluate
9 things, that you don't mistake correlation
10 with causation. If you just ask a certain set
11 of people are you of this type and do you do
12 more of this? That tells you nothing about
13 the influence of the two behaviors you see of
14 one each other.

15 Q At the end of the day, though, you
16 don't have any reason to dispute the finding
17 here, you just don't know the specific
18 underlying data points. Correct?

19 A Well, the finding is that people
20 that stream more, that the streamers buy more
21 CDs. That is not a finding that people that
22 streaming leads to greater CD purchases. It

1 doesn't tell you whether they bought more CDs
2 before they were streamers or fewer CDs before
3 they were streamers. It doesn't relate the
4 streaming to increased purchases of CDs. It
5 just relates it to people that happen to buy
6 more CDs.

7 Q It doesn't suggest that people who
8 are streaming are not buying as many CDs as
9 they used to, does it?

10 A It doesn't suggest anything in
11 terms of what the affect of streaming is on CD
12 purchases.

13 Q Now, you made an assumption that
14 you testified about yesterday that subscribing
15 to the benchmark on-demand services could to
16 lead to two less CD purchases per year.
17 Correct?

18 A Yes.

19 Q And you adjusted for that in the
20 manner that you testified about?

21 A Right. And again, this is all
22 relationship, not that it will lead to two CDs

1 but that versus subscribing to a interactive
2 or non-interactive, would lead to two more CDs
3 being purchased.

4 Q And the number two, where did the
5 number two come from?

6 A Actually, I believe it was
7 suggested to me by counsel to see whether,
8 just to test it out in a simulation analysis.
9 Uhm --

10 Q Now -- sorry.

11 A I was just going to say, it seemed
12 like a reasonable assumption to me at the
13 time.

14 Q Now, from the label's perspective,
15 focusing on your benchmark market on-demand
16 services, they're collecting on average, or
17 the services are collecting, on average \$8.29
18 per subscriber. Right? That was your
19 finding?

20 A That was my -- that was the
21 average price I used. Correct.

22 Q And based on the greater of

1 formulation and the 47.7 percent rev share, I
2 think it's fair to say, is it not, that
3 approximately \$4 of that \$8.29 would be
4 expected to flow through to the labels?

5 A I'll accept that.

6 Q At a minimum?

7 A Well, yes. It depends exactly how
8 the percentage of revenue applies, but
9 something like that.

10 Q Okay. Let's \$4 because it's nice
11 and round.

12 A I'm fine with round numbers.

13 Q So that means that the labels are
14 getting \$48 a year from those people that are
15 now subscribing to these on-demand streaming
16 conditional down-load services. Right?

17 A Right.

18 Q And if all they are losing from a
19 substitutional standpoint is two CDs a year,
20 if you calculate it, they'd be losing a little
21 bit over \$10 and \$11 in income by virtue of
22 that substitutional effect. Right?

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 A Yes, at \$11.20, yes.

2 Q Now, that would put the labels way
3 ahead, wouldn't it? I mean, they're getting
4 \$48 that they didn't have before by these on-
5 demand, streaming limited download services
6 and, with the two CD assumption, only losing
7 two CDs a year. So, they're coming away
8 pretty well off by this new form of
9 distribution. Right? It's \$48 minus \$10.50,
10 so they come away with \$36 and change more
11 than they had before. Correct?

12 A I would expect that to be true and
13 I think that's entirely logical to suggest
14 that's what is going on. Otherwise, they
15 would not -- if they're not going to make much
16 on these services, they're not going to be
17 very intent to set the price where they do.

18 Q Well but isn't it true, sir, from
19 an economic perspective, they're ahead of the
20 game, even if those interactive services had
21 a substitutional impact of up to six or seven
22 CDs a year, or more than that?

1 A Well I think we -- let's get the
2 numbers right.

3 Q Well, if they're making \$48 they
4 didn't have before, --

5 A Right.

6 Q -- and they're losing --

7 A A little over four CDs would be
8 where they'd -- four times, let's use \$12,
9 round the \$11.20 --

10 Q No, no, let's take on an income
11 perspective --

12 A \$11.20.

13 Q -- you used \$5 whatever it was, \$5
14 --

15 A I used \$11 -- I'm sorry. You're
16 right. \$5, you're right, absolutely.

17 Q So it would be seven or eight CDs
18 --

19 A Yes.

20 Q -- that, even if those services
21 caused a substitutional impact of seven or
22 eight CDs, the labels are ahead of the game.

1 Right?

2 A Well, ahead of the game meaning
3 they make money on this service where above
4 and beyond what they were otherwise making,
5 yes. They're making money from their
6 different and new use of their copyrighted
7 material.

8 Q Well, my question is really, why
9 two? Why not consider a higher number
10 associated with the substitutional impact of
11 your benchmark market services, given the fact
12 that the labels are getting that \$48 instead
13 of the substituted four CDs?

14 A Well, I think there are number of
15 reasons for this. First, if you start to make
16 this number much bigger, and we're doing some
17 rounding here, so I could quarrel with exactly
18 how much of the margin is accounted for by the
19 loss of CD sales, but if you make it too big,
20 you're positing that the record companies are
21 choosing to set a price for use of their music
22 and interactive webcasting which yields them

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 a very small margin. And it doesn't make
2 sense that they would be satisfied with a very
3 small margin, if that's what is happening at
4 that price. They'd try to raise the price and
5 as long as they don't cause a significant, an
6 overwhelming repression of demand, they're
7 going to make more money. The smaller your
8 margin, the more you're going to want to raise
9 your price because it doesn't cost you that
10 much when you lose customers. So, that's
11 number one.

12 Number two, two CD sales is a lot.
13 Even though the Arbitron data you showed me
14 and that I really initially reviewed showed
15 average CD sales of about ten per customer,
16 and higher numbers for certain classes of
17 customers, I think that's a vast overestimate
18 of the actual average annual CD purchases, if
19 you look at shipments of CDs in the United
20 States.

21 Q The bottom line is you chose two
22 because counsel recommended it --

1 A I --

2 Q -- and there's a big difference
3 between two and whatever number of CDs these
4 labels could afford to have substituted for
5 and still have a margin associated with your
6 benchmark market services. Correct?

7 A There is still, I agree there is
8 still a margin. I agree that there's a good
9 margin. And I agree that I chose two because
10 counsel suggested it. I also testify that
11 two, in my mind, is a very large number
12 relative to what we see of CD sales in the
13 country.

14 Q You are aware, are you not, that
15 record companies are making promotional
16 expenditures to promote air play of their
17 records by webcasters?

18 A Yes.

19 Q And that indicates to you, does it
20 not, that record company representatives
21 believe that those expenditures will result in
22 an increase in sales of recorded music.

1 Correct?

2 A Yes.

3 Q Now, in your adjustments that you
4 make in connection with your model, you don't
5 seek to capture or make any adjustment for
6 that promotional value of statutory licensed
7 webcasting, do you?

8 A I -- let's see for a second. The
9 promotional -- what I addressed in my
10 testimony is what I called net substitution or
11 promotion. So the two CD difference is an
12 attempt to show through simulation what would
13 be the effect on my recommendation if I had a
14 two CD positive difference which could either
15 be through increased substitution from the
16 benchmark, or could be from increased
17 promotion from the target. So, it considers
18 both ends of that. I just want to make sure
19 that's clear.

20 Q But you didn't consider
21 explicitly, on a standalone basis, what affect
22 that promotional value had on your model or on

1 the rate setting in this proceeding. Correct?

2 A I did not have, and similar to the
3 substitution numbers we were talking about, I
4 did not have any evidence of the extent to
5 which webcasting, in general, promotes the
6 sale of CD records. I'm not talking about
7 promotion of the particular hit albums, I'm
8 talking about the overall change in CD sales
9 that would be expected by the record company
10 as a result of having more customers
11 subscribing to statutory webcasting services.

12 Q You'd agree, through, as a matter
13 of just math, that if that relative two CD
14 assumption you made was larger, then that
15 would have an affect on what the rate is that
16 you would recommend to the panel. Correct?

17 A Yes.

18 Q And the larger that substitutional
19 differential, the lower the fee. Correct?

20 A Yes.

21 Q Turn, if you will, to page 18 of
22 your written testimony. This is where you

1 discussed the musical work, the benchmark.

2 A Yes.

3 Q First of all, the reference in the
4 first full paragraph on this page, where
5 you're talking about music services providing
6 interactive DATs, license fees for sound
7 recordings in the range that you put in your
8 testimony here, that's a direct reference to
9 your, what we talked about earlier, your
10 benchmark market interactive on-demand
11 streaming services. Right?

12 A Yes.

13 Q And the comparison that you make
14 and that you refer to in your footnote with
15 respect to musical works, that's the musical
16 work rate associated with those on-demand
17 streaming conditional download services and
18 the mechanical music licensing aspects
19 thereof. Correct?

20 A The performance and the
21 mechanical, yes.

22 Q You're familiar with the fact that

1 there's a difference between the mechanical
2 reproduction rights and the performance
3 rights?

4 A Yes, I am. And I think the
5 footnote discusses the dispute over whether a
6 mechanical fee applies or not.

7 Q Well, you know, don't you, that
8 there's no dispute over the application of the
9 mechanical royalty fee to conditional
10 downloads and permanent downloads?

11 A I wasn't sure about the
12 conditional downloads. I'll take your word
13 for it.

14 Q The dispute that you referred to
15 is whether or not there is a mechanical
16 reproduction in the delivery of an on-demand
17 stream. Right?

18 A Of an on-demand stream but then I
19 said here in the footnote, performance and
20 musical works by interactive services.

21 Q So this discussion here is in
22 relation to the musical work situation as it

1 pertains to on-demand streaming, conditional
2 download services, and actually permanent
3 download services, too. Right?

4 A Which part of the discussion? The
5 discussion in general is referring to the
6 amounts paid to the musical work copyright
7 holder for interactive services and it, as I
8 said in the footnote, it gives a range
9 depending on different interpretations of the
10 mechanical license fee of somewhere between
11 dispute ranging between 6.9 percent and 14
12 percent.

13 Q And that's what you read from this
14 article that you pulled up?

15 A Yes.

16 Q Now, so it's clear that the whole
17 discussion doesn't deal with the rates that
18 prevail for non-interactive statutory
19 webcasting services. Correct?

20 A I'm not exactly sure what your
21 question is.

22 Q The discussion doesn't relate to

1 musical work performance fees for non-
2 interactive statutory licensed webcasting.
3 Correct.

4 A This is pointing to markers
5 comparing where there are both of them
6 negotiated in the market. So, at this point
7 in the testimony, I only am referring to the
8 interactive. That's correct. Okay.

9 Q Now, You make a statement on this
10 page that differentiates between the factors
11 of production depending on their scarcity
12 value and then you say, to the extent that
13 popular recording artists are scarcer than
14 musical composers, the returns to the
15 recording artist will be higher. Do you see
16 that?

17 A I do.

18 Q You're familiar with the fact, I
19 think you actually may have testified to it a
20 little bit, that there are many songs that are
21 recorded by multiple people?

22 A Yes.

1 Q If I had a song that was recorded
2 by 20 different people and I wanted to have a
3 performance of that song, I could choose from
4 any one of 20 renditions of it. Correct?

5 A If I wanted to purchase it as a
6 consumer? I'm sorry, I know it's a little --

7 Q Whether you wanted to purchase it
8 as a consumer as a download or whether you
9 want to hear it as an interactive stream, if
10 there are 20 different versions of a song and
11 I'm neutral as to the performance, then which
12 is scarcer, the song or the performed version
13 thereof?

14 A If you're neutral then it's not
15 very scarce. If a customer is just as willing
16 to buy a song recorded by you versus Barry
17 Manilow, then, you know, Barry Manilow is not
18 going to get a lot of money for recording
19 music.

20 Q Well then, as a practical matter,
21 neither musical works nor sound recordings are
22 scarce. Correct?

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 A They are scarce from the
2 standpoint of how they're valued in the
3 market.

4 There is talent and what we're
5 talking about is scarce talent. It's the same
6 thing that operates in any market where there
7 are anyone can do it but not everyone can do
8 it well. So, I could play professional
9 basketball just as well as LeBron James but I
10 doubt I would get the same compensation he
11 gets. So, LeBron James is scarce.

12 Q You wouldn't get any compensation,
13 would you? You wouldn't be in that market
14 because you're not in that market.

15 A If the market is exclusively
16 professional basketball, that's correct, I
17 wouldn't be in it.

18 Q Now, you then make a reference to
19 screenwriters, actors and directors as a point
20 of your rationale here. Now, just to be
21 clear, screenwriters, actors and directors are
22 not licensed on a blanket license basis.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 Correct?

2 A Correct.

3 Q So, individual negotiations occur
4 between whether it be motion picture or TV
5 companies and individual actors, directors and
6 scriptwriters over their primary compensation.
7 Correct?

8 A Yes. I mean, there's union
9 affects but, in general, I agree with you.

10 Q I want to ask you some questions
11 about your testimony about the mobile premium.

12 First of all, you'd agree that

13 CHIEF JUDGE SLEDGE: Mr.
14 Steinthal, before you go into that, you want
15 to take a recess for now?

16 MR. STEINTHAL: Sure.

17 CHIEF JUDGE SLEDGE: Recess for
18 ten minutes.

19 (Whereupon, the foregoing matter
20 went off the record at 11:02 a.m. and went
21 back on the record at 11:14 a.m.)

22 CHIEF JUDGE SLEDGE: We'll come to

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 order.

2 CROSS-EXAMINATION (CONT'D)

3 BY MR. STEINTHAL:

4 Q Dr. Pelcovits, questions about
5 mobile for a moment. Would you agree with the
6 proposition that the market for delivery
7 through mobile devices of webcast services is
8 a relatively new market?

9 A Yes.

10 Q Do you know exactly how new?

11 A Not specifically, no.

12 Q It's within the last several
13 months, isn't it?

14 A I believe that's correct. I was
15 going to say within the last year or so.

16 Q Now, is it correct that you have
17 to be, as an economist, cautionary about
18 making any broad economic assumptions based on
19 data from an immature market?

20 A I think there's limits, to some
21 extent, what you can say about it. I would
22 agree that you want more data and more

1 information, if possible, in making
2 conclusions, yes.

3 Q Isn't it true that pricing in new
4 markets can sometimes fluctuate wildly in the
5 first two or three years of a market?

6 A Yes, it can fluctuate, absolutely,
7 as products are being introduced and brought
8 to market, yes.

9 Q And is one of the things that can
10 lead to fluctuations in price as more and more
11 companies become engaged in the supply of
12 similar product?

13 A That's the competition in entry we
14 were talking about earlier. So, you've come
15 around to my side.

16 Q So, the answer is yes, is it not?

17 A Yes.

18 Q And are you familiar with the fact
19 that in the mobile business, in particular,
20 there has been a lot of different products
21 flowing into the market year by year?

22 A In the mobile market?

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 Q Yes.

2 A You're talking about mobile music
3 or just mobile in general?

4 Q Mobile telephony product-wise?

5 A Oh, sure.

6 Q And there are competing offerings
7 by mobile companies of different content that
8 people can subscribe to. Correct?

9 A Content, varieties of accessing
10 content. There's a lot of things going on in
11 the market, yes.

12 Q And a lot of that is emerging as
13 we speak. Correct?

14 A Yes.

15 Q Now, I believe on page 61 of your
16 testimony and then in your direct, you talked
17 about the inadequacy, maybe inadequacy is the
18 wrong word, the lack of a lot of observations
19 of data upon which you could rely. Correct?

20 A Yes.

21 Q In your written statement you say
22 the data is not rich enough, those are your

1 words, and then I think on your direct
2 testimony you said that you didn't have enough
3 observations upon which to make a conclusion
4 about mobile rates relative to other rates.
5 Correct?

6 A No. I said that I did not have
7 enough observations in order to extend the
8 hedonic regression. It didn't mean I couldn't
9 draw some conclusion that they are priced in
10 the market generally higher than the non-
11 mobile services.

12 Q Well, I think you said that six
13 observations were what you had for mobile and
14 they're the ones on page 60 of your testimony.
15 Is that right?

16 A That's correct.

17 Q If six observations are not enough
18 for you to do a regression analysis -- is that
19 what I understood you to say?

20 A It depends. I mean, you have to
21 try. We did try the regression analysis and
22 it didn't give anything meaningful. There was

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 not enough power in the regression to come up
2 with a significant coefficient estimate.

3 Q Well, if six observations aren't
4 enough, is there a rule of thumb to any degree
5 of how many observations you need to conduct
6 a regression that you can have any confidence
7 in?

8 A No.

9 Q Is it typically more than six?

10 A It depends on what you're trying
11 to regress. If you're trying to, you know,
12 look at a time trend for five years of, you
13 know, production of a particular product in a
14 new country, you might be able to do a
15 regression. You're essentially drawing a
16 straight line. People do it all the time and
17 they draw conclusions from it. So, six is not
18 necessarily insufficient. In this case it
19 was.

20 Q In this case it was insufficient?

21 A In order to extend the regrssion
22 analysis, yes.

1 Q Now, the fact is that your
2 regression, as it relates to your benchmark
3 market, involved only seven interactive
4 services. Correct?

5 A I think, if you include the
6 portable and non-portable. I'd have to check
7 how many there were.

8 Q Well, if you include portable and
9 non-portable and don't double count, in other
10 words, if it's the same entity, it's Napster
11 and Napster to Go portable, and Rhapsody and
12 Rhapsody to Go portable, if you don't double
13 count those, isn't it true that the
14 observations that you used for your
15 regression, that you testified about earlier,
16 involved seven different services?

17 A I don't call it double counting if
18 they are two different prices available in the
19 market. There are some prices here that from,
20 for example, Rhapsody Radio and Rhapsody Radio
21 is provided by Rhapsody. So that is an
22 observation. As I said, --

1 Q So if we don't -- let's get over
2 the semantics about double counting or not.
3 You'd have ten observations if you included
4 portable and non-portable. Right?

5 A Sounds about right, yes, but I'd
6 have to double check.

7 Q So somewhere between six and ten
8 we have enough observations to go from
9 something that's not reliable to something
10 that is?

11 A It depends on the data and how the
12 data varies, how easy it is to explain it, how
13 consistent it is across the data. If you have
14 six observations that are very tightly grouped
15 and consistent across the board in their
16 characteristics, it might be sufficient to
17 draw a conclusion. You can look at the data
18 and, in fact, I would say that behind any
19 attempt to dig deeper into a regression, let's
20 look at an obvious, what the data says to you.

21 The regression is a technique to
22 work with the data. The regression is

1 consistent with what I showed here. It
2 doesn't take a lot of very fine tuned analysis
3 to see that overall there is a ratio between
4 interactive and non-interactive in the market
5 in this general range that I've talked about,
6 about 55 percent, give or take. That's not
7 true with respect to the mobile internet radio
8 services where the characteristics are
9 different from the non-mobile services with
10 respect to channels and other features so it's
11 very hard to sort out. And that's what a
12 regression would need to do and why it would
13 need more data. It needs to sort out the
14 specific effect of mobility on the price.

15 And that's the goal of the
16 regression and that's what I said by not
17 having enough data.

18 Q Let's talk about the data you did
19 have, okay?

20 A Yes.

21 Q The box on page 60.

22 A Yes.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 Q Now, Mobzilla?

2 A Yes.

3 Q Do you know what Mobzilla is?

4 A I do. I tried it out. It's a --
5 I got it on my sign up and I think I did it as
6 a trial, I don't think I shelled out the
7 money. And you get to listen to whatever
8 channel, I think it was whatever channel you
9 preselected when you signed up and you listen
10 to it on your cell phone. I'm not sure how
11 you switch channels, but I'm aware, generally,
12 what it is.

13 Q Well, who does the consumer pay,
14 the phone company?

15 A They pay Mobzilla.

16 Q What is Mobzilla? Is it a
17 communications company or is it a webcaster?

18 A I don't know. It's available in
19 the market.

20 Q You don't know whether it's a
21 phone company or a webcaster?

22 A I don't know. I don't know who is

1 Mobzilla other than it is available in the
2 market, if you go to the market and try to buy
3 the service. And I did not buy this through
4 my phone company. So, whether they are owned
5 or partly owned by a phone company, it doesn't
6 matter to me. They are something that I, as
7 a subscriber to Verizon Wireless can get by
8 signing up online and paying my \$4.

9 Q And you say the number of stations
10 is 30. Does that mean you can get 30 stations
11 delivered to your phone or do you choose -- or
12 --

13 A You can choose which of the 30 you
14 want to listen to. I don't recall how it sets
15 up, being able to switch channels, whether you
16 can do that. I think you can do that from
17 your phone. I don't recall exactly how its'
18 done.

19 Q Now, MusicChoice, --

20 A Uh-huh.

21 Q -- that's the same service that
22 delivers digital music to homes. Correct?

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 A I don't recall.

2 Q Do you know how the price point
3 here of \$5.95 relates to what consumers pay if
4 they pay on an a la carte basis for the
5 MusicChoice service delivered to the home?

6 A No, I don't.

7 Q Skip down to Sirius Sprint.
8 That's the satellite service, is it not, that
9 operates under the SDARS statutory license?

10 A That is, it's the Sirius part of
11 it, but it's marketed through Sprint, I
12 believe. Q Well it's true, is it
13 not, that the channels being delivered there
14 are the same channels available on satellite
15 radio through Sprint, but available here on
16 the webcast market. Right?

17 A It's the same programming for 20
18 channels. You get 20 of the channels.
19 Obviously, not all of them.

20 Q Now, The satellite services are
21 delivered to a stationery, -- they're
22 delivered to a device that you can only listen

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 to in your car. Correct? Under the statutory
2 license?

3 A I know that Sirius and XM, the two
4 satellite providers, are now selling or
5 providing service through other radios. They
6 don't have to be in your car.

7 Q Well, you've read about the
8 challenge by the recording industry to those
9 devices, have you not?

10 A I have not.

11 Q You're aware that the recording
12 industry is seeking to have legislation passed
13 that makes sure that the Satellite companies
14 can't take the or sell devices that would
15 enable consumers to capture the streams and
16 then play them back?

17 A First of all, that isn't what I
18 was talking about. You said, do you have to
19 listen to it in your car? You can get a
20 Sirius radio and carry it around with you or
21 put it by your beside. I was just commenting
22 on what's available in the market. I'm not

1 basing or saying anything about what anyone is
2 claiming before Congress or anyplace else.

3 Q Now, you would agree, however,
4 with the proposition that satellite radio, as
5 delivered through XM and Sirius, is not as
6 portable as delivering music by cell phones.
7 Right?

8 A I would say, presently, that's
9 probably the case, given the devices we have
10 now and given not just portability, but just
11 the ubiquity of, at present, of cell phones,
12 rather than satellite receivers.

13 Q And certainly prior to today, and
14 in the years 2003, 4 and 5, the XM and Sirius
15 services have not been available on as
16 portable a basis as cell phones provide.
17 Correct?

18 A Well, portable meaning are they
19 small, can you carry them everywhere, correct.
20 In terms of being available in your car, they
21 are, I would say, easier to use, in some
22 sense, in that sense, more portable than

1 trying to hook up a cell phone to your car's
2 audio system.

3 Q Well --

4 A I mean, I've tried to listen --
5 I've listened to XM in my car and I've tried
6 to listen to things from my cell phone in my
7 car, and it's a lot easier to listen to XM.

8 Q In your car?

9 A In my car.

10 Q But when you're not in your car,
11 it's a lot easier to listen, that's the whole
12 point of your discussion about mobile service
13 premiums is that you can listen to music
14 anywhere. Right?

15 A Anywhere -- yes, virtually
16 anywhere. It depends on how good your cell
17 phone reception is.

18 Q Certainly not in my hotel.

19 Now, what I'm trying to understand
20 here is, you say that the data reflects that,
21 and this is on page 60, the new mobile
22 services appear to command a premium in the

1 marketplace. Right?

2 A Yes.

3 Q Now, the Sirius service, when it's
4 purchased for the car, costs twice that
5 amount, doesn't it?

6 A That's about right, yes.

7 Q So, where we have a situation
8 where when I'm purchasing my subscription to
9 Sirius which, up until now has been limited
10 utility in the car, subject to your testimony,
11 I pay \$12 a month, but now, now that I can
12 have it on my mobile phone, I'm going to pay
13 half as much. Not twice as much, half as
14 much. Right?

15 A If you want to just look at price
16 without looking at that other column there,
17 number of channels, 20. So, you can do any
18 calculation you want.

19 You can say on a per channel
20 basis, you're paying a lot more for Sirius on
21 a Sprint phone than you are for Sirius in your
22 car.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 Q And have you done any study of how
2 many different channels people tend to listen
3 to when they subscribe to Sirius?

4 A How many they listen to and not
5 how many are available? No.

6 Q Okay. And did you consider, in
7 your testimony that talked about how mobile
8 services typically command a premium, that
9 with respect to one of the services on your
10 chart, in fact the price for the mobile
11 service is half as much of the price of the
12 offline service, if you will, off-mobile
13 service?

14 A You're just asking with respect to
15 Sirius, to be specific?

16 Q That's one of the six observations
17 you have here, yes.

18 A And I would repeat my answer,
19 which is, it's not the same service if you're
20 getting 20 channels rather than over 100
21 channels.

22 Q Now, with respect to MSpot Radio

1 and MSpot Music Radio, what are those
2 services? What is the difference between the
3 two?

4 A At this point, I don't recall.

5 Q Are they owned by different
6 companies?

7 A As I said, I don't recall.

8 Q Do you they operate statutory
9 license webcasting services or different kinds
10 of webcasting services?

11 A I don't recall.

12 Q What about Mobzilla? Do you know
13 whether they are operating services under the
14 statutory license or not?

15 A I don't know but the nature of the
16 service, as I have used it, is similar to a
17 statutory land line service in the sense of
18 being a stream of preprogrammed music.

19 Q You haven't analyzed whether it's
20 within or not the sound recording performance
21 compliment?

22 A No. I've looked at this from the

1 consumer standpoint.

2 Q Is MSpot Radio sold by a company
3 that is a programmer of webcasting under the
4 statutory license or a telephone company, a
5 mobile company?

6 A I don't recall.

7 Q Do you know whether any of the
8 prices include the price of delivery?

9 A What do you mean by that?

10 Q It wasn't a very good question.
11 I'll rephrase it.

12 Are you familiar with the fact
13 that mobile phone providers sell access to a
14 number of things, right? At this point?

15 A Yes.

16 Q They sell access to telephone
17 service. Correct?

18 A They provide telephone service.

19 Q Right. And they provide a series
20 of programming options that consumers can
21 choose to buy or not from the cell phone
22 company?

1 A I mean, I wouldn't put it that
2 way. They provide, you know, options of
3 different packages that the customer can get
4 which have a whole set of attributes.

5 Q Well, I'm trying to figure out
6 whether you know whether, in connection with
7 these services, what the relationship is
8 between the mobile company and the actual
9 provider of the content. In other words, does
10 to the consumer contract with the phone
11 company to obtain the delivery of the service
12 and then the phone company have a relationship
13 with the service itself?

14 A In some cases the customer does
15 business with the cell phone company and, in
16 other cases, this is provided independently.

17 Q Well, in which cases is it that
18 the consumer has the relationship with the
19 cell phone company?

20 A Sirius Sprint. I don't know about
21 the others. I do know that there has been,
22 you know, various, very changing deals offered

1 by Sprint. So, I don't know if any of the
2 other cell phone companies have been very
3 active at marketing music services.

4 Q Do you know whether any of the
5 companies operating under the statutory
6 license are making their webcasts available
7 through cell phone companies today?

8 A Well, the Rhapsody services, it's
9 the same company that's offering the customer
10 among its various services, the mobile
11 service.

12 Q Well, do you know whether the
13 Rhapsody service that's available on mobile
14 requires you to contract with the mobile
15 company from whom you get your cell phone
16 reception?

17 A I don't believe it does.

18 Q Do you know that one way or the
19 other?

20 A I'm not certain but I would, quite
21 frankly, I'd expect it's similar to Mobzilla,
22 that they could -- certainly, Rhapsody can set

1 up a system that customers can connect to
2 without having to purchase or designate that
3 with their cell phone company. It's certainly
4 technology that's there. I've used it. It
5 works.

6 Q Do you know whether any of that
7 \$6.95 that you put down for Rhapsody goes to
8 the cell phone company that enables the
9 delivery to the consumer?

10 A Not that I know of.

11 Q You don't know one way or the
12 other?

13 A I'm not certain but if the service
14 can get that to the customer without the cell
15 phone companies active participation, they
16 don't have to give any to the cell phone
17 company.

18 Q And do you know whether it's
19 possible to get it to the cell phone user
20 without the active participation of the cell
21 phone company?

22 A They don't have to agree to it, as

1 long as they don't block it. It's a
2 broadband, it's a stream of bits and, if the
3 customer has the right equipment, it can be
4 put over the air and, as any sort of bits are
5 put over the air, and the customer can listen
6 to it. I mean, I've done it. I know it
7 works.

8 Q Now, let me ask you this question.
9 When a consumer buys a CD at a store, let's
10 call it \$16.95 for the sake of argument, you
11 pay just \$16.95 for the CD, if that's all
12 you're going to buy, and you walk out. Are
13 you with me so far, just in terms of --

14 A Yes. We've lost our round
15 numbers.

16 Q Okay. Yes, well, we're not going
17 to do much math with his.

18 A Okay.

19 Q If you're home and you call the
20 store and you say, look, I really want the new
21 CD that came out, will you FedEx it to me and
22 the store says yes, then you would expect,

1 would you not, that the consumer would pay the
2 \$16.95 plus the cost of delivery. Right?

3 A If you want it overnight, yes.

4 Q Now, are you familiar with the
5 fact that there are a number of products being
6 sold by mobile companies where the consumer
7 pays an aggregated fee for the product plus
8 the cost of delivering right there on your
9 mobile phone?

10 A Yes, ringtones, V CAST type of
11 things, other types of content, yes.

12 Q If, in the situation where you
13 were buying something that has a market value
14 of X and then you're asking that it be
15 delivered in a particular way, have you heard,
16 in the economic literature, the reference to
17 that situation as being an aggregated price,
18 with some portion of it being for delivery?

19 A Not in that terminology but there
20 is certainly -- if you're trying to say that
21 something has a cost to be able to listen to
22 it in addition to what you have to pay from

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 the, let's say the store, or whoever is
2 providing it to you, that is the cost to the
3 customer and the customer is incurring a cost.
4 So, if a customer has to subscribe and pay
5 more to his cell phone company and pay an
6 extra \$4 to be able to have the right to get
7 Mobzilla, then the customer is still paying \$4
8 to Mobzilla. And that's -- those are the
9 prices I'm showing you. I'm not showing the
10 final cost to the customer. I'm not including
11 the cost here, I'm not including that in the
12 cost of the equipment needed to play CDs or
13 the computers needed to play webcasts.

14 Q And you don't know how much of
15 this monthly price listed for the six
16 observations that you've made, consists, if at
17 all, of delivery charges. Right?

18 A In some cases, clearly none. In
19 other cases some. But in all cases, it's what
20 the customer pays and it's an indication that
21 customers will pay a premium to have music
22 streamed to their cell phones, compared to

1 just being able to get it on their computers.

2 Q And is it your testimony that even
3 though the product may be identical and the
4 difference in cost to the consumer may be the
5 cost payable to the phone company for
6 delivering it in the fashion of a mobile
7 device, that the sound recording companies
8 should get an increased royalty merely because
9 there's a delivery component in the cost to
10 the consumer?

11 A That's too long a question for me
12 to answer. I'm serious. I didn't comprehend
13 it.

14 Q Well, in the hypothetical of a
15 situation where it's the identical music being
16 delivered over the computer and over the cell
17 phone and to the customer, they pay a greater
18 fee of \$2 than they would otherwise pay for
19 example, --

20 A Pays \$2 more?

21 Q Right.

22 A Okay.

1 Q If it subscribes to the service
2 through the mobile company rather than just
3 the internet service, would you attribute the
4 entirety of that \$2, which enables you to get
5 the service by mobile as well as by computer,
6 to the revenue base against which a sound
7 recording royalty would apply?

8 A Not necessarily and I don't think
9 it would matter whether there is a cost, a
10 share of this paid to the cell phone company
11 or there is a cost the customer incurs to get
12 the service. I'm -- the share of revenue that
13 I think the copyright holders should get
14 should reflect the value to the consumer and
15 a higher price is indicative of a higher value
16 to the consumer. Part of that might be
17 because it's more expensive to get it to him.
18 Part of it might be, you know, various other
19 reasons. But I hope that answers it. I was
20 struggling.

21 Q Let me ask you to move to page 57
22 of your report. Am I correct that in pages 57

1 up to the top of 58 what you've done is
2 compare the ratio of prices charged by sound
3 recording companies for preprogrammed or non-
4 interactive music as compared to interactive
5 music?

6 A No. I both do that comparison and
7 I also present the share of revenue that is
8 received for both types of video, music
9 videos.

10 Q Well, let's focus on the ratio.
11 First of all, you've, in your testimony,
12 recommended that when we look at the relative
13 value of a benchmark market on-demand service
14 compared to a target market non-interactive
15 service, we should look at the difference
16 between what the consumer pays for the
17 benchmark market service as compared to what
18 the consumer pays for the non-interactive
19 service. Right?

20 A Right.

21 Q Now, you could look at it the
22 other way. Right? You could, if you wanted

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 to look at ratios of value, look at the
2 difference between what the seller charges for
3 interactive product compared to what the
4 seller charges for non-interactive product.
5 Right?

6 A I assume the consumer buys what
7 the seller sells. So, that's the market
8 price. I don't know -- I don't understand the
9 distinction that you're trying to draw.

10 Q Well you have focused, for the
11 model you want to put forward here, on what
12 consumers pay for two different kinds of
13 services, your benchmark market service, which
14 is interactive on-demand streaming, and your
15 non-interactive target market services.
16 Right?

17 A Yes.

18 Q Now, that doesn't tell us what the
19 sound recording companies value their
20 copyrights for in terms of the relative value
21 from their perspective, as they sell their
22 product. Does it?

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 A It doesn't. And primarily, the
2 statutory rate is set in one case and the
3 other is based on a willing buyer and a
4 willing seller.

5 Q Well, let's focus on the willing
6 sellers because the consumer is not either the
7 willing buyer or the willing seller in the
8 willing buyer/willing seller analysis that the
9 panel has to set. Right?

10 A That's correct.

11 Q So, let's focus on the seller.
12 You would agree, would you not, that as you
13 discuss here on page 57, when the sound
14 recording sellers sell licenses to music
15 videos for streaming on the internet, they set
16 rates that are differential, typically, from
17 what they charge for on-demand interactive
18 streaming as distinguished from preprogrammed
19 non-interactive streaming. Right?

20 A On a per stream basis or a per
21 play basis, yes. Not on the revenue
22 percentage.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 Q But on a per stream basis, the
2 ratio, I think, you point out, on page 57
3 carrying over to 58, is roughly five to one?

4 A Right.

5 Q So that the non-interactive stream
6 is something they charge on a per play basis,
7 one-fifth of the on-demand stream. Right?

8 A When that's what's actually paid
9 on the greater of contract, yes. That
10 characterizes that part of the rate structure.

11 Q And are you familiar with the fact
12 that,--

13 MR. STEINTHAL: And I'm going to
14 ask this question and ask that the question
15 and answer be restricted, Your Honor, because
16 it reveals information provided by one of the
17 labels on a restricted basis. So, I'm just
18 assuming that if I were to ask the witness
19 whether he's aware of the particular price
20 point of a particular label, the gentlemen on
21 the other side would request that we have that
22 restricted. It's just one question and

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 answer.

2 CHIEF JUDGE SLEDGE: Your motion
3 is not sufficiently specific to generate a
4 response.

5 (Whereupon, the foregoing matter
6 went off the record at 11:47 a.m. for a closed
7 session.)
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22

1 BY MR. STEINTHAL:

2 Q In doing your comparability
3 analysis, sir, as between the target market
4 and the benchmark market services, you didn't
5 consider the fact that one is subject to
6 statutory licensing and one is not. Correct?

7 A In the sense of -- yes, that's
8 underlying my analysis is the facts are what
9 they are in the market. I did consider it
10 because if it wasn't a statutory rate in one
11 market and it was -- they were both willing
12 buyer and willing seller, we wouldn't have to
13 be here.

14 Q Okay. That's a fair answer.
15 Putting that aside, that we wouldn't have to
16 otherwise be here, did you take into
17 consideration any Congressional intent
18 associated with services operating under the
19 statutory license?

20 A If you mean legislative history,
21 no.

22 Q So you didn't consider any factors

1 that may underlie why the statutory license
2 exists in the first place? Any legislative
3 history factors, to be clear?

4 A I did not.

5 Q Would it affect your analysis at
6 all if you were aware that labels in
7 establishing the prices in your benchmark
8 market in part did so with an intent to
9 establish good precedent for statutory rate
10 setting?

11 MR. HANDZO: Objection. I think
12 this was asked and answered yesterday.

13 CHIEF JUDGE SLEDGE: Mr.
14 Steintal?

15 MR. STEINTHAL: I'm pretty
16 confident I didn't ask that question.

17 CHIEF JUDGE SLEDGE: You're asking
18 him to conjecture on the opinion of someone
19 that entered into a contract?

20 MR. STEINTHAL: I'm asking him
21 whether it would affect his analysis if he had
22 evidence that labels, in establishing prices

1 in the benchmark market, did so in part to
2 establish precedent for statutory rate
3 setting?

4 MR. HANDZO: In addition to the
5 Court's concerns, I'm fairly confident that he
6 did ask that question because I can tell you
7 what the answer is. He can get it again from
8 the witness, but he's already answered it.

9 CHIEF JUDGE SLEDGE: Objection
10 overruled.

11 THE WITNESS: I frankly don't
12 remember what I said before. So, I would have
13 to say, would it affect my analysis? I
14 basically say I can't answer that in the
15 abstract. I think there's far too much market
16 evidence for me to think that this is being
17 driven by intent to affect the statutory rate.

18 BY MR. STEINTHAL:

19 Q Now you're aware, are you not,
20 that in 2003, two years before you undertook
21 to conduct the analysis underlying your model,
22 that SoundExchange and its label members

1 voluntarily agreed to rates for statutory
2 license webcasts under a different framework,
3 correct, a licensee option?

4 A Right. There wasn't added option
5 to the 0.007 cent per play.

6 Q But you're aware that two years
7 before you did your model, there was a
8 voluntary agreement between SoundExchange and
9 the webcasters that established rates, at the
10 licensee's option for subscription services of
11 10.9 cents -- sorry, 10.9 percent with a 27
12 cent per sub minimum or a per usage rate
13 either based on a 0.0007 cents per play or
14 1.17 cents per hour?

15 A I am aware of that.

16 Q Now, as of 2003 when that
17 agreement was entered into, the interactive
18 services in your benchmark market already had
19 an established rate structure of the greater
20 of, essentially, 50 percent of revenue, a
21 penny a play, or somewhere between \$2.50 and
22 \$3 per sub, isn't that right?

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 A Yes.

2 Q If you recall in reference to your
3 testimony about table 6.2, you said that you
4 wanted to have a sanity check on your
5 regression, right? And that's partially what
6 6.2 was?

7 A Yes.

8 Q Did you do any sanity check of
9 your model's results against what the
10 recording industry voluntarily agreed two
11 years beforehand?

12 A That would be an insanity check.
13 I mean, to apply a carry forward of a rate
14 from a previous CARP decision rather than
15 reenter into another litigated situation is
16 not a market. So, that would not be sane.

17 Q As an economist you don't presume
18 that actors enter into deals that they don't
19 believe are acceptable for them under the
20 circumstances in the market at the time
21 they're negotiating. Correct?

22 A Under the circumstances, the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 market including all of the institutional,
2 legal and other factors that are present
3 affecting what they believed they would get if
4 they didn't complete the negotiation.

5 Q And that's true as to both sides
6 to a negotiation, in your view. Right?

7 A Yes.

8 Q And I gather then that because you
9 felt that it was an insanity check, you didn't
10 seek to conduct any analysis of why it was
11 that your model came out to the results that
12 it came out to so disproportionately to the
13 voluntary agreement that was entered into by
14 SoundExchange in 2003?

15 A I've already said, I think, that
16 whether it's the original CARP rate or the
17 carry forward that was agreed to, that that
18 was not a market determined rate because it
19 was either set by the CARP or carried forward
20 to avoid another hearing right away.

21 Q Now, on page 29 to 30 of your
22 written statement and also on your direct

1 testimony, you pointed out that if you take in
2 isolation just one of the three elements of a
3 greater of formula, either the per sub, the
4 per play, or the percentage, you, in essence,
5 undervalue that element. Correct?

6 A I don't know if I used the
7 undervalued but I said it would not take
8 account of the tradeoffs that went into the
9 greater of formulation and would lead to a
10 lower rate than would otherwise be
11 appropriate.

12 Q If you turned it around, flipped
13 it over, and you were looking at a lesser of
14 or licensee option framework, the same would
15 be true, would it not, in the sense that if
16 you were looking at a lesser of formula and
17 you had a choice of choosing to play on a per
18 play, per hour, or percentage of revenue rate,
19 then looking at any one of those elements on
20 their own, would effectively overestimate the
21 actual amount agreed to. Correct?

22 A If you were to adopt that.

1 Looking at it and adopting it are two
2 different things. But if you were to take a
3 three part lesser of structure and just get
4 rid of two of the three options, it would do
5 that.

6 MR. STEINTHAL: I have no further
7 questions, Your Honor.

8 Oh, one minor thing, Your Honor.
9 I wanted to move into evidence one of the
10 schedules from the witness, which I think
11 would be helpful to the panel as well. I'm
12 going to mark as Services Exhibit 63,
13 Attachment A to the witnesses report.

14 (Whereupon, the above-
15 referred to document
16 referred to as Services
17 Exhibit No. 63 was
18 marked for
19 identification.)

20 CHIEF JUDGE SLEDGE: Is this
21 identification for something in the direct
22 statement?

1 MR. STEINTHAL: It's not in the
2 actual, the direct statement, but it's
3 referred to. If it was in, we wouldn't be
4 doing this. It was produced in discovery.
5 Let me just ask the witness.

6 BY MR. STEINTHAL:

7 Q Is this schedule a schedule of 17
8 agreements and the details about the 17
9 agreements which you testified about
10 underlying the benchmark market?

11 A Let me check. Yes.

12 MR. STEINTHAL: I'd offer Exhibit
13 63 into evidence.

14 CHIEF JUDGE SLEDGE: Any objection
15 to Exhibit 63?

16 MR. HANDZO: No, Your Honor. I
17 would note, however, that it was produced
18 subject to the protective order and,
19 therefore, ask that it be designated as
20 restricted in this record.

21 CHIEF JUDGE SLEDGE: There being
22 no objection, the exhibit is admitted.

1 (Whereupon, the document
2 marked as Services
3 Exhibit No. 63 for
4 identification was
5 received into evidence.)

6 CHIEF JUDGE SLEDGE: Any objection
7 to submitting the exhibit to the provisions of
8 the protective order?

9 (No response.)

10 CHIEF JUDGE SLEDGE: With no
11 objection, the motion to submit to the
12 provisions of the protective order is granted.

13 Mr. Steinthal, you are now
14 concluded?

15 MR. STEINTHAL: Yes. Thank you,
16 Your Honor.

17 CHIEF JUDGE SLEDGE: Mr. Joseph,
18 do you wish to begin your cross-examination
19 for a half an hour?

20 MR. JOSEPH: I do, Your Honor.

21 CHIEF JUDGE SLEDGE: All right.

22 MR. JOSEPH: Although I would

1 appreciate about three minutes to do the
2 transfer of places.

3 CHIEF JUDGE SLEDGE: Go right
4 ahead.

5 MR. JOSEPH: Thank you.

6 THE WITNESS: Could I use that
7 three minutes to run to the mens' room, Your
8 Honor?

9 CHIEF JUDGE SLEDGE: Certainly.

10 THE WITNESS: Thank you.

11 CHIEF JUDGE SLEDGE: We'll recess
12 for five minutes.

13 THE WITNESS: Okay. Wonderful. I
14 appreciate it.

15 (Whereupon, the foregoing matter
16 went off the record at 12:02 p.m. and went
17 back on the record at 12:06 p.m.)

18 CHIEF JUDGE SLEDGE: We will come
19 to order. Mr. Joseph?

20 MR. JOSEPH: Thank you, Your
21 Honor.

22 BY MR. JOSEPH

1 Q Good afternoon, Mr. Pelcovits. We
2 met, of course, at your deposition. Right?

3 A Good afternoon -- or -- yes, it
4 is. Good afternoon, Mr. Joseph.

5 Q I was waiting to see whether I was
6 going to get to say good afternoon or good
7 morning. But we crossed that.

8 Just to start, to make sure that
9 we're speaking the same language, Dr.
10 Pelcovits, your written testimony uses a
11 couple of terms that we didn't hear yesterday
12 and today. And I just want to make sure we
13 understand them.

14 I believe one of the terms is
15 interactive DAT and NI-DAT. Correct?

16 A Yes.

17 Q Okay. And by interactive DAT, in
18 your written testimony, and I think at times
19 in your deposition when we were talking back
20 in early March, you mean interactive digital
21 audio transmission services. Correct?

22 A Correct.

1 Q And yesterday in your oral
2 testimony and, I think, at times today, you
3 referred to the market for these sound
4 recording performance license for those
5 services as your benchmark market. Correct?

6 A Yes.

7 Q And by NI-DAT, you meant the non-
8 interactive webcasters covered by the
9 statutory license. Correct?

10 A Correct.

11 Q And you referred to the market for
12 sound recording performance licenses for NI-
13 DAT services as your target market. Correct?

14 A Correct.

15 Q Okay. Now, with respect to each
16 type of service, would it be accurate to say
17 that there are at least two markets? On the
18 one hand, the market for the sound recording
19 performance license, which is a market where
20 the seller is the licensor or the record
21 companies and the buyers are the services and
22 a market for the services to consumers where

1 the sellers are the services and the buyers
2 are consumers?

3 A Yes.

4 Q Now, a little earlier today when
5 you were talking to Mr. Steinthal and said
6 that you used a competitive market model for
7 the purpose of estimating the rate, you were
8 referring there, I believe, you also testified
9 to your model, assuming that the consumer
10 market for the webcasting services was
11 competitive, not necessarily that the
12 benchmark market for the sound recording
13 licenses was competitive. Correct?

14 A That's what I was referring to,
15 yes.

16 Q Now, in fact in your analysis you
17 didn't make any assumptions about the
18 competitive status of your benchmark market.
19 You just took that market as it is. Correct?

20 A It's fair to say I took the market
21 as it is and I think I said in my testimony,
22 I believe, that there's no monopoly power in

1 that market, in the market, in the record
2 industry as a whole. That it's a workably
3 competitive market.

4 Q And you base that, if I understood
5 your testimony, on the prior CARP decision and
6 then on a review of changes in that market as
7 a result of the Sony-BMG merger and the review
8 of that merger by the Federal Trade Commission
9 and the European Commission. Correct?

10 A I based the adoption of using the
11 sellers as they are now based on the previous
12 CARP decision. It's straight forward
13 application except with respect to the change
14 in the industry from B5 to B4.

15 I based my statement on the market
16 being generally workably competitive, is the
17 term I think I used in my deposition to refer
18 to the record industry as a whole on the
19 findings of the Federal Trade Commission that
20 approved the BMG-Sony joint venture, subject
21 to the anti-trust laws.

22 Q Now, if you please turn to page 10

1 of your written statement where there's a
2 paragraph that I believe was referred to
3 yesterday, or a sentence at the end of the
4 first paragraph, where you say the willingness
5 of a seller to offer a service at a particular
6 price is, in large measure, a function of its
7 cost, the effect of sales of one service on
8 sales of other services sold by the same
9 company, and the intensity of competition in
10 the marketplace, both in the large and the
11 short run.

12 It's true, is it not, that you
13 didn't analyze your benchmark market to
14 determine the intensity of competition in that
15 market. Correct?

16 A Other than to refer to the federal
17 government's review of the market as a whole,
18 I did not.

19 Q Now, just to be clear with respect
20 to your reliance on the prior CARP decision,
21 do you understand the CARP in 2001 to have
22 analyzed the licensed, the market for sound

1 recording licenses for interactive digital
2 audio transmission services to determine
3 whether it was competitive?

4 A I believe they adopted it and
5 accepted the competition in the market, as it
6 stood at that point. Exactly how they
7 referred to it, the term competitive, or
8 whatever, I don't recall.

9 Q Now, when you say they adopted it
10 and referred to the market, I'm referring here
11 specifically to the market for sound recording
12 licenses for interactive digital audio
13 transmission services. Did you understand the
14 CARP to have analyzed whether or not that
15 market was competitive?

16 A I don't recall that I made a
17 specific analysis of the term, whether it's
18 competitive or not. I'd have to go back and
19 look.

20 Q Do you recall whether they
21 analyzed that particular market at all?

22 A Well, they used that market for

1 the basis of determine what a willing seller
2 was. And they said that the willing sellers
3 were the record companies.

4 Q So it's your understanding that
5 the CARP used the market for the sale of sound
6 recording licenses to interactive digital
7 audio transmissions services as the basis for
8 its decision?

9 A I don't know if you can say they
10 used the market. They used the sellers in the
11 market and they treated those as the willing
12 sellers.

13 Q But did they analyze that market
14 specifically?

15 A I don't recall.

16 Q Well, do you recall your
17 discussion with Mr. Steinthal earlier this
18 morning where it was represented that that
19 market barely had started by 2002?

20 A Yes.

21 Q So, at the time that the CARP was
22 deciding, there wouldn't have been very much

1 to analyze with respect to that particular
2 market, would there have been?

3 A Well, you're looking at a market.
4 It's one of the many markets in which sound
5 recordings are provided. And I would say you
6 can't, in terms of any market competition
7 analysis, just say let's look at one piece of
8 the market without looking at the entire
9 behavior and actions of the record companies
10 as an industry in and of itself. It's an
11 industry that sells in multiple channels. I
12 would not look at the sale in a particular
13 channel as an analysis of workable
14 competition.

15 Q So, it's your testimony that when
16 anti-trust authorities review mergers, they
17 don't look at each of the markets in which the
18 sellers participate?

19 A They might. They might not. It
20 depends on the nature of those markets, the
21 firms in the market, and how they go about
22 analyzing it.

1 Q Well, do you understand the prior
2 CARP to have actually analyzed whether any
3 market for the licensing of sound recording
4 performance rights was competitive?

5 A I know they used the working --
6 I'm sorry. They used existing record
7 companies as the willing sellers. Exactly how
8 they referred to competition and what
9 specifically they said about the nature of the
10 competition in the market, I don't recall. I
11 do recall they looked at the issue of how does
12 a market function and they adopted, as I said,
13 willing sellers as the record companies. They
14 chose that as the market to look at.

15 Q But I'm not sure -- I don't
16 believe that answered my question. My
17 question was, do you know whether the prior
18 CARP actually analyzed whether any market for
19 the licensing of sound recording performance
20 rights was competitive?

21 A I don't know what they analyzed.
22 I know there's some statements about

1 competition in the market. I don't recall the
2 specific wording or contents.

3 Q And do you have any understanding
4 of what evidence, if any, was presented to the
5 CARP on the question of whether and to what
6 extent the record companies competed with each
7 other for the licensing of sound recording
8 performance rights?

9 A I don't believe it. I believe
10 they looked and compared the option of -- they
11 compared the option of either looking at the
12 copyright holder having the copyright or
13 multiple parties having the same copyright
14 right. And they said the purpose of using
15 this standard was to look at the actual
16 copyright holder having that right.

17 Q Sir, once again, I don't -- maybe
18 my question wasn't clear. Let me try it
19 again. But I don't think you answered it.

20 I asked whether you had any
21 understanding of what evidence, if any, was
22 presented to the CARP on the question of

1 whether and to what extent the record
2 companies competed with each other for the
3 licensing of sound recording performance
4 rights? And do you have any understanding of
5 what evidence, if any, was presented to the
6 CARP on the question of whether and to what
7 extent the record companies compete with each
8 other as sellers in any market? What
9 evidence?

10 A Right. I do not know what
11 evidence was presented to them.

12 Q And I take it you would agree that
13 the CARP did not evaluate whether any
14 particular agreements negotiated by the
15 existing record companies were negotiated in
16 a competitive market, but instead relied on an
17 agreement between the RIAA collective and
18 Yahoo as its primary benchmark. Correct?

19 A That was the benchmark they relied
20 on. I'll agree with that.

21 Q Would you -- do you know whether
22 they evaluated whether any particular markets

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 negotiated by the record companies were
2 negotiated in a competitive market?

3 A I do not recall.

4 Q Would you agree that the market for
5 the sale of physical CDs is a different market
6 than your benchmark market, the market for the
7 sound recording performance right for
8 interactive digital services?

9 A Can we be precise on terminology?
10 Do you mean the sale of CDs by the record
11 companies to the retail outlets or the
12 retailing of CDs overall?

13 Q Sale of CDs to the retail outlets
14 to the record companies.

15 A And the question is, do I regard -
16 - is that a different market from the market
17 for the sale of or the provision of
18 performance rights to the webcasting services?

19 Q Well, to the interactive digital
20 services, your benchmark market.

21 A Right. Do I think it's a
22 different market? It is a different market

1 with very similar characteristics. With very
2 similar characteristics.

3 Q Now, I believe yesterday, at one
4 point in your testimony, I think it was on
5 direct, you said that the "market has been
6 found to be competitive." Can you tell me,
7 first of all, what market you were referring
8 to when you said that?

9 A I was referring to the record
10 industry as a whole and looking at whether the
11 industry is workably competitive, I think, is
12 generally the term I prefer to use because we
13 don't almost ever see a perfect textbook
14 competition. But, that's what I was referring
15 to.

16 Q And again, by found to be
17 competitive, you were referring to the fact
18 that the FTC decided not to challenge the
19 Sony-BMG merger?

20 A That's what I'm referring to, yes.

21 Q By the way, in considering that
22 issue, did you also take into account and

1 review the European Commission decision with
2 respect to the Sony-BMG merger?

3 A I did.

4 Q And are you relying on that for
5 your conclusion about the finding to be
6 competitive as well?

7 A I'm relying on both of those
8 decisions to support a general statement that
9 the record industry is workably competitive,
10 not to try to analyze any specific market in
11 which they participate.

12 Q Now, considering the Sony-BMG
13 merger to which you have referred, is it your
14 understanding that the Federal Trade
15 Commission would have applied the FTC and
16 Department of Justice merger guidelines in its
17 analysis?

18 A Yes.

19 Q Did you review the merger
20 guidelines?

21 A I have many times, yes.

22 Q And one of the things that the FTC

1 would have looked at when it was evaluating
2 the merger was the concentration of the sound
3 recording industry. Correct?

4 A Yes.

5 Q And, if anything, the Sony-BMG
6 merger made the sound recording industry more
7 concentrated than it previously was. Correct?

8 A Yes.

9 Q Now, it's true, is it not, that
10 the primary measure of concentration used by
11 the Justice Department and by the Federal
12 Trade Commission when it evaluates mergers is
13 something called the Herfindahl-Hirschman
14 index. Correct?

15 A Yes.

16 Q And can you explain how the
17 Herfindahl-Hirschman index for an industry is
18 calculated?

19 A Yes. It's calculated by taking
20 the market shares of the participants and
21 taking the square of those market shares and
22 then summing it up.

1 Q So, if you have one participant in
2 a market, the HHI would be 10,000, which is
3 100 squared. Right?

4 A Correct.

5 Q Now, if you have an atomistic
6 market where each company has a small
7 fractional share of the market, the HHI
8 actually approaches zero. Right?

9 A That's mathematically right, yes.

10 Q So, that's your range. You go
11 from zero to 10,000. Right?

12 A Close to zero to 10,000, yes.

13 Q Approaching zero. Would it be
14 correct to say epsilon to 10,000?

15 A Epsilon, I like that. Yes.

16 Q Now, just to give the panel a
17 sense of how the HHI scale works, if you have
18 two companies in a market and each had a 50
19 percent market share, the HHI would be 5,000.
20 Right?

21 A Right.

22 Q That would be 50 times 50, which

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 is 2,500, twice. You have to double it.
2 Right?

3 A Correct.

4 Q Because there's two firms?

5 A Yes.

6 Q And if you had four companies,
7 each with a 25 percent market share, the HHI
8 would be 2,500. Right? 25 squared is 1,250,
9 I believe.

10 A Good, I'm glad you're doing the
11 math for me.

12 Q Well, I'm going to ask you to do
13 some math in a second, so --

14 A Oh, okay. Well, I didn't bring my
15 calculator but I'm ready.

16 Q But would you agree that at four
17 firms --

18 A Four firms, 25 times 25 times 4.
19 So, 2,500.

20 Q Okay. And you would agree, would
21 you not that both the DOJ, or the DOJ and the
22 FTC, in the merger guidelines, divide the

1 spectrum of market concentration as measured
2 by the HHI into three regions that they
3 broadly characterize as unconcentrated,
4 moderately concentrated, and highly
5 concentrated. Correct?

6 A That sounds right. I don't
7 remember the exact terminology. I'll take
8 your word for it.

9 Q And it sets the ranges for those -
10 - well, rather than play guessing games, why
11 don't we pass out the merger guidelines so
12 that you can look at it.

13 MR. HANDZO: If I can just
14 interpose an objection to try and move this
15 along? Some amount of cross-examination on
16 his assumptions is certainly fair but I would
17 submit that we are well beyond the scope of
18 direct at this point.

19 CHIEF JUDGE SLEDGE: Mr. Joseph?

20 MR. JOSEPH: Your Honor, the
21 fundamental conclusion was that, of his direct
22 testimony and on which his entire presentation

1 has to be based, is that the underlying market
2 that he uses as a benchmark, is workably
3 competitive or is a competitive marketplace.
4 Especially given the statutory standard in
5 this case, which is that the -- your job is to
6 find the price that would -- most willing
7 buyers would pay willing sellers in a
8 competitive market.

9 And he has testified that he
10 believed, on direct, that it was workably
11 competitive and that it was found to be so by
12 these anti-trust authorities.

13 It seems to me fundamental to
14 cross-examination to probe the basis for that
15 conclusion, the basis for that understanding,
16 what he relied upon, and indeed whether or not
17 his reliance on the idea that his benchmark
18 market is a workably competitive or
19 competitive market that would be one that you
20 should give any credit to for the purpose of
21 deciding what a willing buyer would pay a
22 willing seller is fundamental to my cross-

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 examination.

2 CHIEF JUDGE SLEDGE: Why aren't
3 those legal arguments?

4 MR. JOSEPH: They are in part --
5 there's some legal argument but there's a lot
6 of foundation, including what this witness
7 relied on in reaching his conclusion with
8 respect to that marketplace.

9 MR. HANDZO: If I could just
10 respond, Your Honor? I think his fundamental
11 conclusion was that the CARP, last time, said
12 the willing sellers are the record companies
13 and that's what he used as his willing
14 sellers. Beyond that, I think we're getting
15 into the underpinnings of the original CARP
16 decision which I think is water long under the
17 bridge and I just don't see how, with all the
18 other issues we have to deal with, how we can
19 try an anti-trust case in the middle of this
20 case.

21 MR. JOSEPH: May I, Your Honor?
22 We're actually not getting into the

1 underpinnings of the prior decision. He said,
2 the witness has testified, that he relied on
3 these merger approvals for the competitive
4 nature of his benchmark and that he didn't
5 rely -- he relied on the underlying CARP to
6 define the market, but the question of whether
7 or not that market is competitive and whether
8 he was reasonable in relying on it, goes to
9 the nature of his analysis, the validity of
10 his analysis.

11 CHIEF JUDGE SLEDGE: All right.
12 The objection is overruled.

13 BY MR. JOSEPH:

14 Q Dr. Pelcovits, I've just handed
15 you a document marked as Services Exhibit 64.
16 Have you seen that document before?

17 A I have.

18 Q And that is the Justice
19 Department, FTC merger guidelines. Correct?

20 A It is.

21 (Whereupon, the document
22 referred to as Services

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

Exhibit No. 64 was marked
for identification.)

BY MR. JOSEPH:

Q I would ask you, please to since
we were talking about ranges, I would ask you
please to turn to page 15 of the guidelines,
where the ranges of unconcentrated, moderately
concentrated and highly concentrated are set
out. Correct?

A Yes.

Q Okay. And it's correct, is it
not, that the guidelines identify an
unconcentrated market as below 1,000,
moderately concentrated between 1,000 and
1,800 and highly concentrated as an HHI above
1,800. Correct?

A Yes.

Q Now, do you know what the sound
recording industry's HHI is after the Sony-BMG
merger? Have you calculated it?

A I haven't. It's in the range of
-- I don't know. I'd say it's close, it's in

1 the range of 2,000 or so. It might be a
2 little lower, it might be a little higher. If
3 you had five firms each with 20 percent market
4 share, you'd get that number. So, here you
5 have some firms a little bigger and you have
6 many other firms, though I haven't calculated
7 the exact number.

8 Q Let me hand you a document that
9 may facilitate the math. Give one to opposing
10 counsel, okay? Now, I'm handing out -- I'm
11 sorry --

12 I've handed out a document that
13 was produced under the protective order by
14 Universal, one of the major labels and we'll
15 see whether, let me see whether the
16 examination is one that we can do without
17 requiring any motion for restriction. If you
18 would turn to -- and these are excerpts from
19 a PowerPoint presentation that we will have
20 described in greater detail when Mr. Kenswil
21 takes the stand, Your Honor.

22 (Whereupon, the document

referred to as Services

Exhibit No. 65 was marked

for identification.)

BY MR. JOSEPH:

Q But if you turn to the page that's
marked SX76616, there is a graph there, Dr.
Pelcovits, marked U.S. Nielsen SoundScan total
out in market share first half of 2005 and it
gives market shares for each of the four major
labels. Just for the purpose of getting a
rough number, I'd ask you to assume that those
market shares are accurate and ask you whether
it's not correct that the HHI for the
recording industry, based on those market
shares, is approximately 2,200? You can do
the math or --

A I can do the math or say, yes. Or
we could --

Q Well, -- I'm sorry.

A It's going to be in that range. I
can see that simply from the first two
calculations, yet.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 Q So, about 2,200, you agree?

2 A That makes sense to me.

3 MR. JOSEPH: Your Honor, I can see
4 now we've approached 12:30. I'm going to
5 start on an additional line in this same area,
6 but it will take some time. So, I'm, you
7 know, I would suggest that this is a good time
8 to break, if that's what Your Honor would
9 like.

10 CHIEF JUDGE SLEDGE: But you're
11 going to continue on this line of questioning
12 about what the -- about the analysis of
13 mergers --

14 MR. JOSEPH: I'm going to --

15 CHIEF JUDGE SLEDGE: -- in the
16 Justice Department?

17 MR. JOSEPH: And the Federal Trade
18 Commission and what they looked at. Yes, Your
19 Honor.

20 CHIEF JUDGE SLEDGE: All right.
21 We'll recess until 2:00.

22 (Whereupon, at 12:34 p.m., the above-

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 entitled matter recessed to reconvene at 2:03
2 p.m. the same day.)

3 CHIEF JUDGE SLEDGE: Thank you.
4 We'll come to order.

5 MR. HANDZO: Before we begin,
6 SoundExchange has filed its opposition to the
7 motion to strike Ms. Fink's testimony. I have
8 courtesy copies here, they've already been
9 distributed in the courtroom. If the Court
10 would like copies, I can give them to you now.

11 CHIEF JUDGE SLEDGE: Please.

12 Mr. Joseph?

13 MR. JOSEPH: Thank you, Your
14 Honor.

15 In an effort to expedite the
16 discussion of the merger approvals, what I'm
17 going to do is actually hand out, let me count
18 the number of documents, six documents that
19 have been marked and try to get a sense or an
20 understanding from the witness of what the
21 witness saw and relied on and what he didn't.
22 And I think that will help move things along.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 BY MR. JOSEPH:

2 Q Okay now, Dr. Pelcovits, I have
3 handed you Services Exhibits 66, 67, 68, 69,
4 51, because that had already been shown to a
5 witness earlier in the case, and 70. I ask
6 you -- let's do them one at a time.

7 In reviewing the FTC and European
8 Commission approvals of the Sony-BMG merger,
9 did you review the document marked Services
10 Exhibit 66?

11 A I did.

12 (Whereupon, the document
13 referred to as Services
14 Exhibit No. 66 was marked
15 for identification.)

16 BY MR. JOSEPH:

17 Q Okay. Did you review the document
18 marked Services Exhibit 67?

19 A Yes.

20 (Whereupon, the document
21 referred to as Services
22 Exhibit No. 67 was marked

for identification.)

BY MR. JOSEPH:

Q Did you review the document marked
68?

A I don't recall reviewing each
letter, but it's the same letter. So, I
remember reviewing the letter.

(Whereupon, the document
referred to as Services
Exhibit No. 68 was marked
for identification.)

BY MR. JOSEPH:

Q Did you review the document marked
Services Exhibit 69?

A Yes.

(Whereupon, the document
referred to as Services
Exhibit No. 69 was marked
for identification.)

BY MR. JOSEPH:

Q Okay. Were these the FTC
documents you were referring to when you said

1 you reviewed the FTC discussion of the Sony-
2 BMG merger and that you relied on in reaching,
3 in part, in reaching your conclusion?

4 A I relied on these as evidence that
5 the FTC did not block the merger and I
6 inferred, based on my knowledge of merger
7 practice and approval practice that, as I said
8 in my testimony, that the industry and the
9 firms don't have a monopoly power.

10 MR. JOSEPH: I would offer
11 documents, Services Exhibits 66, 67, 68, and
12 69 on that basis.

13 CHIEF JUDGE SLEDGE: Any
14 objections to 66, 67, 68, and 69?

15 MR. HANDZO: No, Your Honor.

16 CHIEF JUDGE SLEDGE: No objection.
17 Each of these exhibits is admitted.

18 (Whereupon, the documents
19 marked as Services
20 Exhibits No. 66 through
21 69 for identification
22 were received

1 into evidence.)

2 BY MR. JOSEPH:

3 Q Now I ask you, Dr. Pelcovits, to
4 take a look at Exhibit 51, which purports to
5 be the European Commission Order or Discussion
6 -- Decision in the merger case. Did you
7 review this document, and is that part of what
8 you relied upon?

9 A Yes.

10 MR. JOSEPH: I would offer Exhibit
11 51.

12 CHIEF JUDGE SLEDGE: Any
13 objections to Exhibit 51?

14 MR. HANDZO: No.

15 CHIEF JUDGE SLEDGE: Without
16 objection, Exhibit 51 is admitted.

17 (Whereupon, the document
18 marked as Services
19 Exhibit No. 51 for
20 identification was
21 received into evidence.)

22 BY MR. JOSEPH:

1 Q And I would ask you to look at
2 Services Exhibit 70, Dr. Pelcovits. This
3 appears to be an article by a Susan Manning
4 and Helen -- Eileen Reed that, among other
5 things, on page 8669 discusses the merger and
6 it was identified in an inter -- excuse me.
7 Withdraw that.

8 This purports to be an article by
9 Ms. Reed and Manning that on page 8669
10 discusses the Sony-BMG merger and it was
11 identified in an interrogatory response as a
12 document that you reviewed in connection with
13 the merger by SoundExchange. Have you seen
14 this article?

15 A I have. I think it actually
16 starts on 8668 and continues to 8669.

17 (Whereupon, the document
18 referred to as Services
19 Exhibit No. 70 was marked
20 for identification.)

21 Q That's fine.

22 MR. JOSEPH: And I would offer

1 this document, as well.

2 CHIEF JUDGE SLEDGE: Any objection
3 to Exhibit 70?

4 MR. HANDZO: No, Your Honor.

5 CHIEF JUDGE SLEDGE: Without
6 objection, Exhibit 70 is admitted.

7 (Whereupon, the document
8 referred marked for
9 identification as
10 Services Exhibit No. 70
11 was received
12 into evidence.)

13 BY MR. JOSEPH:

14 Q Now, I would ask you, Dr.
15 Pelcovits, take a look at document 69, which
16 is the statement of Commissioner Thompson in
17 connection with the merger. Among other
18 things, at the top of the second paragraph,
19 Commissioner Thompson notes the history of
20 facilitating practices, is the word he uses.
21 Can you tell us what facilitating practices
22 are?

1 A Generally, that's a term used to
2 describe practices that enable or facilitate
3 the practice of coordinated behavior among
4 firms in an industry.

5 Q And he also refers to practices
6 referring -- ranging from alleged anti-
7 competitive minimum advertising price programs
8 to agreements to fixed prices unlimited
9 advertising. Let me ask you if you are
10 familiar with the alleged anti-competitive
11 minimum advertised price program that
12 Commissioner Thompson is referring to?

13 A I might have reviewed it at one
14 point, I don't recall it at this point.

15 Q Well, let me see if we can refresh
16 your recollection.

17 Do you recall reviewing this
18 document or a document about the subject
19 matter discussed in this document in
20 connection with your review of the sound
21 recording industry?

22 (Whereupon, the document

1 referred to as Services
2 Exhibit No. 71 was marked
3 for identification.)

4 A I do not recall reviewing this.

5 Q You don't. Do you recall the
6 subject matter?

7 A If you give me a minute, please?

8 Q Sure. Take your time.

9 A Does this have a date on it for
10 the --

11 Q I believe the only date that it
12 has on it is the web, the URL date, which
13 shows September 2000 or 2000/09.

14 A Okay. Thank you.

15 I'm sorry, is the question did I,
16 have I relied on this and reviewed this?

17 Q Have you reviewed that document in
18 connection with your review of the recording
19 industries?

20 A I have not.

21 Q Were you aware when you considered
22 whether or not the sound recording industry

1 was workably competitive that the Federal
2 Trade Commission had filed a complaint in
3 September of 2000 against the major record
4 companies after finding, among other things,
5 that they had engaged in anti-competitive
6 conduct facilitating horizontal collusion in
7 connection with the sale of CDs?

8 A I was not aware of this specific
9 proceeding. I am aware that there have been
10 a variety of anti-trust investigations of the
11 record industry.

12 Q When you say anti-trust
13 investigations, as one who has experience in
14 anti-trust matters, is it your understanding
15 that the issuance of a complaint and the
16 acceptance of a consent decree is the same as
17 simply an investigation when its pursued by
18 the FTC?

19 A No.

20 Q And what's the difference?

21 A Consent decree is the resolution
22 of a complaint. So, it obviously is a -- I

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 would say it provides more basis for believing
2 that the issues raised in the complaint are,
3 have some higher probability of being proven
4 than those where there's purely a complaint
5 without a consent decree.

6 Q It is true, is it not, that the
7 FTC won't issue a complaint unless they find
8 reason to believe that violations of the anti-
9 trust laws have occurred. Correct?

10 A I don't know whether that's their
11 operating standard, whether it's a reason to
12 believe basis or -- I'm not sure.

13 Q You don't know their operating
14 standard?

15 A Not for issuing a complaint, I
16 don't know what the operating standard is.

17 Q By the way, turning back to the
18 letters, Exhibits 67 and 68, to understand
19 formally what the FTC did, it would be correct
20 to say that it decided not to take enforcement
21 action. Correct?

22 A That is the formal declaration and

1 that is essentially the same, it has the same
2 effect as a finding that the merger does not
3 violate anti-trust law.

4 Q Well it's true, is it not, sir,
5 that the letter says this action is not to be
6 construed as a determination that a violation
7 may not have occurred?

8 A That's what it says.

9 Q Now with respect to the European
10 Commission Decision you said you reviewed, did
11 you consider that decision to be a reliable
12 discussion of the relevant markets related to
13 the sound recording industry?

14 A I considered their finding and
15 their approval of the merger as supportive of
16 the statement that I made in testimony and
17 deposition that the recording industry is
18 workably competitive. That's the degree to
19 which I relied on it.

20 Q Did you examine the specific
21 discussion of the online music market?

22 A I do recall a discussion in the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 decision on that.

2 Q More than -- well, let me hear
3 what my question was again, please.

4 (Question read back.)

5 BY MR. JOSEPH:

6 Q And did you examine that
7 discussion --

8 A I wasn't able to hear it, could
9 you please repeat it?

10 Q Well, let me just ask a question.
11 Did you examine and rely on the discussion of
12 the online music market in forming your
13 opinion that the industry was workably
14 competitive?

15 A Not specifically, no.

16 Q By the way, do you have an
17 understanding of the laws governing European
18 Commission review of mergers, generally?

19 A I have a -- I can't say that I can
20 recall the exact wording of the laws, but I've
21 lived through merger approval processes in
22 Europe, been there, sat through proceedings --

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 Q Would you -- sorry.

2 A So, I've had -- I know it from
3 experience, not from reading the law.

4 Q And is it your understanding that
5 the laws of the European Union impose very
6 specific requirements on the commission before
7 it can successfully challenge a merger?

8 A I don't recall specific
9 requirements. I recall, from experience, the
10 nature of the way they proceed and how they
11 look at anti-trust issues. And I'd say it's
12 comparable, if not more aggressive than the
13 U.S. anti-trust authorities.

14 Q Is it your understanding that the
15 Commission has to develop a cogent and
16 consistent body of evidence that supports each
17 of several specific elements in order to
18 challenge a merger?

19 A I did not recall that's the exact
20 standard.

21 Q Do you know whether or not the
22 burden of proof is on the Commission or on the

1 merging parties in a European Commission
2 proceeding challenging a merger?

3 A I believe it's on the Commission
4 to prove it.

5 Q By the way, just so when the Board
6 looks at this decision, could you please turn
7 to page 73 -- I'm sorry, paragraph 73 on page
8 25. And the Commission speaks about examining
9 whether any price coordination on the basis of
10 a parallelism in average prices could have
11 been reached using certain list prices. Can
12 you tell -- do you have an understanding of
13 what the term parallelism means in this
14 context?

15 A I don't recall specifically what
16 they're referring to. I'd have to go back and
17 reread more of the decision.

18 Q Do you have a general
19 understanding in the context of anti-trust
20 analysis what the term pricing parallelism, or
21 what the term parallelism in connection with
22 prices means?

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 A Well, I assume it's -- I mean,
2 what I would expect is it's referring to price
3 coordination because that's modifying the
4 first part of the sentence. The Commission
5 examined whether any price coordination.
6 There are various ways of looking at price
7 coordination. You can be looking at the
8 actual data on the prices and one part of the
9 examination is whether the prices are the same
10 over time for the firms that are alleged to be
11 coordinating prices. I assume that's what
12 it's referring to. Exactly how they use there
13 and what they said about it, I don't recall.

14 MR. JOSEPH: And, Your Honor,
15 we're actually on page 25, paragraph 73.

16 BY MR. JOSEPH:Q. And in the next
17 sentence, there's a reference to the term to
18 determine whether certain discounts were
19 sufficiently transparent in order to allow
20 sufficient monitoring of any price
21 coordination. Do you have an understanding of
22 what the term transparent means when it's used

1 in that context?

2 A Yes. I think that that's
3 referring to whether the discounts being
4 granted by firm A are known to firm B, so that
5 they can see what the prices, the effect of
6 prices in the market. I can expand if you
7 want me to.

8 Q No, I think that's fine. That's a
9 good basic concept.

10 Are you aware, Dr. Pelcovits, that
11 in its decision, the European Commission
12 determined that the market for online music
13 licenses from the record companies was a
14 distinct market that deserved analysis?

15 A Yes, they said that. And I will
16 just add they said that there were to be exact
17 elimination of markets can be left open, the
18 competitive assessment is the same under any
19 market definition considered. Paragraph 29.

20 Q Is it not true, Dr. Pelcovits,
21 that that statement actually referred to the
22 question of whether online downloading and

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 streaming were part of the same market for
2 distribution of online music or whether they
3 formed separate markets?

4 A Yes.

5 Q So that doesn't go to the question
6 of whether the markets for wholesale licenses
7 for online distribution is itself a market,
8 does it?

9 A Not directly. I think it goes to
10 the general point of careful delineation of
11 these markets is not always the most important
12 part of an anti-trust investigation.

13 Q But, in this case, if you turn to
14 paragraph 24 on page 8, it's true, is it not
15 that the Commission considered online music is
16 not part of the market for physical recorded
17 music and two different markets must, their
18 words must, be distinguished, one of which was
19 the wholesale market for licenses of online
20 music. Correct?

21 A Yes, correct.

22 Q That's what they found in the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 Sony-BMG case. Correct?

2 A That's correct.

3 Q Now let me ask you to turn to page
4 6 of your report -- or I should say, of your
5 written direct testimony.

6 A I have it. Thank you.

7 Q In the only full paragraph on the
8 page, six lines up from the bottom, you say,
9 and this is in -- well, you say that if the
10 price is too high and, in context, I take it
11 that's the price set by this Board or by the
12 prior CARP. Correct?

13 A Correct.

14 Q Parties can (and indeed are almost
15 certain to) negotiate agreements for rates
16 lower than the statutory standard. That was
17 your testimony. Correct?

18 A Correct.

19 Q Now, you wouldn't expect the same
20 effect in a market where the sellers sit
21 together and plan a common strategy for
22 pricing in the market, would you?

1 A Well, that would, that would
2 depend on the specific circumstances.

3 Q Well, if the sellers can be
4 affective at maintaining discipline among
5 themselves, you wouldn't expect that same
6 result to obtain, would you?

7 A It still might.

8 Q But you would expect a different
9 outcome, wouldn't you?

10 A A different than if there was not
11 a perfect discipline among the parties. There
12 would still be an issue whether the industry
13 as a whole would get more revenue by lowering
14 prices. It might still be the same prices
15 but, if by lowering prices you were to
16 increase demand sufficiently to offset the
17 reduced margin, that would still be a
18 profitable strategy. And my sense is that,
19 again, we're dealing with an industry where
20 price competition among the different titles
21 of records does not seem to be an important
22 competitive variable.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 Q Dr. Pelcovits, do you remember
2 when I asked you essentially those same
3 questions at your deposition?

4 A I remember the general topic.
5 Thank you.

6 (Whereupon, the document
7 referred to as Services
8 Exhibit No. 72 was marked
9 for identification.)

10 BY MR. JOSEPH:

11 Q Let's see what your answer was
12 when I asked you then. Would you please turn
13 to page 71 or pages 71 and 72. It's actually
14 on page 19 of the four --

15 A Oh.

16 Q This format puts four deposition
17 pages together on a page.

18 A I'm sorry, page 70?

19 Q 71.

20 A 71.

21 Q It starts on line 24 --

22 A Okay.

1 Q -- where I ask, would you expect
2 the same effect to apply in a market where the
3 sellers sit together to plan a common strategy
4 for pricing in the market. And you said that
5 if you were in a situation whereas you posited
6 in the question, the sellers are sitting
7 together to set prices, as a general matter,
8 if they can be affective at maintaining
9 discipline among yourselves, you're going to
10 get a different outcome than if they act
11 independently. It's just the nature of
12 cartels versus competition.

13 That was your answer then.
14 Correct?

15 A Yes.

16 Q And that's an accurate answer?

17 A Yes.

18 Q By the way, let me ask you to
19 assume hypothetically that the members of such
20 a group that was coordinating pricing knew
21 that any agreement that they entered into
22 below the price that they were trying to reach

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 would become through discovery in a legal
2 proceeding and would be useful as evidence
3 against the goals of setting the common price,
4 that would be a strong disincentive to
5 undercutting the price, wouldn't it?

6 A I suppose it's possible.

7 Q Okay, Dr. Pelcovits, let's turn to
8 page -- it's your written report and I would
9 ask if it's correct from page 30 to page 42 of
10 the report where you described how you derived
11 your recommendation for a per subscriber fee
12 for the sound recording license in the non-
13 interactive, in the target market, from the
14 per subscriber fee for the sound recording
15 license in the benchmark market?

16 A Yes.

17 Q And I believe, when you were
18 talking with Mr. Steinthal earlier, you
19 testified that the assumption that the ratio
20 of the consumer price to the royalty rate
21 would be the same in both the target and the
22 benchmark markets was a key to your analysis.

1 Correct?

2 A Yes.

3 Q And I believe you said, on direct,
4 that you believed that that assumption was
5 correct because you believed the demand
6 elasticity in both markets was likely to be
7 similar. Correct?

8 A Correct.

9 Q Okay. And just so the record is
10 clear, the demand elasticity is the
11 sensitivity of demand to changes in price.
12 Correct?

13 A Quantity and demand --

14 Q As a general statement?

15 A -- is the change in percentage --
16 change in the quantity of demand with respect
17 to a percentage change in the price.

18 Q Which is the numerator, which is
19 the denominator, the percentage change in
20 quantity or the percentage change in price?

21 A The numerator is the quantity, the
22 denominator is the price. So, I think high

1 elasticity means that there's a large quantity
2 change in respect to a small price change.
3 Just so we have the math right, we talk about
4 this in absolute value terms because actually
5 the number is negative. But conventionally,
6 because price -- as price goes down quantity
7 goes up but the convention is to say larger,
8 smaller, even though we're dealing with a
9 negative number.

10 Q Thank you.

11 A I just didn't want to get that
12 confused.

13 Q So now let's turn to page 33 of
14 your written statement and look at figure one.
15 This figure describes graphically your
16 discussion of the relationship between the
17 license fee for sound recording rights paid by
18 music services to the retail subscription fee
19 paid by consumers. Correct?

20 A Yes, it's illustrating that
21 relationship.

22 Q Now, your written statement on

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 pages 32 and 33 calls the line marked DMS, the
2 demand curve for the interactive music
3 services. Right?

4 A Correct.

5 Q But that's not strictly speaking
6 what that line is, is it?

7 A If we're trying to capture what's
8 going on in the market, no, it's not strictly
9 speaking. Correct.

10 Q In fact, you intend the demand
11 curve, line DMS, to be a demand curve facing
12 a single music service. Correct?

13 A I know I said that on deposition.
14 I have to remember now whether it makes a
15 difference whether it's a single music service
16 or whether it's the music service business as
17 a whole. I don't think it matters.

18 Q Well, to be more accurate, didn't
19 you describe it -- or is it not, the demand
20 curve, is it not your testimony that it's the
21 demand curve faced by a single music service
22 with respect to the sound recordings of a

1 single record company?

2 A Right. That part is correct.
3 It's with respect to the sound recordings of
4 a particular record company.

5 Q Now, the line marked DD you intend
6 to be the derived demand of the service for
7 the sound recording input from a single record
8 company. Is that correct?

9 A That's correct.

10 Q And if that's true, then the point
11 P would represent the portion of a license fee
12 for a music service represented by the sound
13 recordings of a single record company.
14 Wouldn't it?

15 A Yes.

16 Q And the point F would represent
17 the license fee paid by the music service to
18 a single record company. Correct?

19 A Correct.

20 Q When you -- is there anywhere in
21 your written testimony that you actually
22 explained the meaning of those lines in terms

1 of a single record company?

2 A No.

3 Q And, in fact, on pages 35 and 36,
4 you describe the points P and F quite
5 differently than you've just described them in
6 this testimony, don't you?

7 A I apply them differently than how
8 I described them earlier. I think we went
9 through this in deposition and I distinguished
10 what I was trying to sort of provide by way of
11 explanation and just the graph and what I
12 eventually did and how I applied it.

13 Q Well, if you would look with me,
14 please, on page 36, in the paragraph at the
15 bottom of the page, second sentence, you're
16 saying as show in table one of Appendix A,
17 which is your list of the contracts, the
18 average per subscriber fee for copyright in
19 the interactive market is \$2.97, corresponding
20 to F on figure one. That's what you said in
21 your testimony. Right?

22 A Correct.

1 Q But that's not in fact what point
2 F represents, is it?

3 A That's not what F represents in
4 the picture, in the graph on page 33 and the
5 economics of this still holds. And I was
6 trying to make it clear. I, obviously, made
7 it less clear.

8 Q And you didn't tell the Board that
9 actually the graph didn't represent what you
10 said it represented on page 36, did you?

11 A I have not amended testimony.
12 That's correct.

13 Q Let's turn to page 34 of your
14 written testimony. You say that the distance
15 -- excuse me one second.

16 The last full sentence in the
17 text, not in the footnotes, you say the
18 distance between the two demand curves is the
19 amount that would cover the other production
20 costs of the music services including a
21 reasonable profit margin. Correct?

22 A Correct.

1 Q Now, when you say the two demand
2 curves, you're referring to the demand for the
3 service and the derived demand for the
4 license. Correct?

5 A Correct.

6 Q And those were the lines DMS,
7 which is the demand for the service, and DD,
8 which is the demand for the license. Correct?

9 A Correct.

10 Q And when you say the other
11 production costs, you're referring to the
12 production costs other than the sound
13 recording license. Correct?

14 A Correct.

15 Q And you don't have any reason to
16 believe that the production costs, plus a
17 reasonable profit margin for non-interactive
18 digital music services are any less than the
19 production costs and a reasonable profit
20 margin for interactive music services. Do
21 you?

22 A I do not.

1 Q And so, if that's true, you would
2 expect the distance between the demand curve
3 facing the music service and the derived
4 demand curve of the music services for
5 licenses to be the same for interactive and
6 non-interactive services. Correct?

7 A Yes.

8 Q Now, on page 34, you say that
9 you've drawn the derived demand curve for
10 sound recordings to be parallel to the demand
11 curve for the music service. Correct?

12 A Correct.

13 Q And you actually give two reasons
14 for doing that. Correct?

15 A Yes.

16 Q Okay. So, let's consider the
17 combined significance of your assumptions.
18 The distance between the derived demand curve
19 and the service demand curve is equal to
20 production costs plus a reasonable profit.
21 There's no reason to believe that the
22 production costs plus a reasonable profit for

1 the interactive services and the non-
2 interactive services differ and the derived
3 demand curve and demand curves are parallel to
4 each other in both markets. Assuming, as your
5 evidence shows, that the consumer subscription
6 fee for non-interactive services are
7 significantly lower than the consumer
8 subscription fee for interactive services,
9 isn't it true that the ration of the license
10 fee to the subscription fee for non-
11 interactive services must be significantly
12 lower than the ratio of the license fee to the
13 subscription fee for the interactive services?

14 A As we stand today, or as the
15 evidence in the market is today with the
16 statutory rate, yes.

17 Q I'm not asking about as we stand
18 with the statutory rate. I'm asking, based on
19 the assumptions as you have made them in the
20 market and your use of the benchmark and
21 target markets?

22 A I think I'm confused about the

1 question then.

2 Q When you talk about the derived
3 demand curve and the service demand curve for
4 the interactive market and the non-interactive
5 markets, you're not talking, when you're
6 talking about the non-interactive market,
7 about the market that we find under the
8 statutory license, you're talking about your
9 hypothetical target market, aren't you?

10 A Well, if I'm observing prices
11 today, which is, if you're asking what is the
12 relationship between the license fee and the
13 retail price for interactive services, what's
14 in the market today does not represent what
15 would occur if the license fee I'm proposing
16 were adopted.

17 Q Well, let me ask the question with
18 -- you're taking your same three assumptions.
19 If you assume that the consumer subscription
20 fee for non-interactive services are
21 significantly lower than the consumer
22 subscription fee for interactive services,

1 isn't it true that the ratio of the license
2 fee to the subscription fee for non-
3 interactive services must be significantly
4 lower than the ratio of the license fee to the
5 subscription fee for interactive services?

6 A Yes.

7 Q Let's take an example using rough
8 numbers. Let's assume that in the interactive
9 market, the average per subscriber license fee
10 is \$3 and the average consumer subscription
11 fee is \$8. That leaves imputed production
12 costs plus a reasonable profit of \$5. Right?

13 A Right.

14 Q Let's assume in the non-
15 interactive market, the average subscription
16 fee is \$6, where these are all per month
17 numbers, as you've used throughout, if you
18 assume that the same production costs plus a
19 reasonable profit apply in the non-interactive
20 market and that's the same \$5, isn't it true
21 that the appropriate license fee indicated by
22 the non-interactive transmission service

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 derived demand curve would be \$6 minus the \$5
2 or \$1?

3 A No.

4 Q And why not?

5 A You're assuming that prices --
6 you're taking evidence from what prices are
7 right now and saying what the fee should be
8 without allowing the market to adjust for the
9 higher fee.

10 Q I wasn't taking any evidence. I
11 was asking you to assume average subscription
12 fees. Are you saying that under your model
13 the subscription fee for the non-interactive
14 services would exceed the subscription fee for
15 the interactive services?

16 A No.

17 Q So, they're going to be less?

18 A It depends on demand. I expect
19 that it would be less, yes. They are less
20 now. I'd expect them to continue to be less.

21 Q Well, didn't your model actually
22 rely on the subscription fees that you

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 observed in the marketplace?

2 A In order to measure the value to
3 consumers of interactivity or the difference
4 in value between an interactive and non-
5 interactive.

6 Q Isn't that exactly what I was
7 doing when I was taking the assumption that
8 the subscription fees -- let me rephrase.

9 Isn't that exactly what I was
10 doing when I was taking the assumption that
11 the price charged to consumers for
12 subscription services was \$8 and the price
13 charged to consumers for non-subscription
14 services was \$6? I was just doing the same
15 kind of analysis you were with round numbers.

16 A No, you weren't.

17 Q How was I doing something
18 different?

19 A You were getting a rate based on
20 existing prices in the market. And the
21 existing prices in the non-interactive market
22 are a function of the rate that was set by the

1 prior CARP. And the relationship between the
2 fee and the price in the market is, again,
3 driven by the existing CARP set rate.

4 Q Was it valid for you, when you
5 looked at the price consumers were willing to
6 pay in the marketplace, to look at the average
7 prices paid by consumers for non-interactive
8 services?

9 A Yes.

10 Q And when you did that, you found a
11 number. Correct?

12 A Yes.

13 Q And if you subtract from that
14 number that you found the same reasonable --
15 I'm sorry -- the same production cost plus a
16 reasonable profit number that you found to
17 exist in the interactive services market,
18 isn't it true that you would actually come out
19 with a negative fee?

20 A Yes.

21 Q Now on page 34, Dr. Pelcovits, in
22 your assumption that the demand, the derived

1 demand curves are parallel, you gave two
2 reasons I think I mentioned earlier. First,
3 you said that sound recordings are a non-
4 substitutable input and second, you said that
5 you assumed that any change in the copyright
6 fee -- I'll withdraw this question actually.
7 I'm sorry.

8 On page 36 of your testimony you
9 state that it's reasonable to assume that the
10 demand elasticities in the interactive and
11 non-interactive markets would be very close.
12 That's been talked about before. But it's
13 true, is it not, that the availability of
14 different substitutes for the two different
15 kinds of services could lead to different
16 demand elasticities in their respective
17 markets?

18 A Yes.

19 Q And other than what you've
20 described in footnote 14, you did not perform
21 any analysis of the demand elasticity in
22 either the benchmark or the target market, did

1 you?

2 A Correct.

3 Q And it's also true, is it not,
4 that the concept of elasticity of demand for
5 non-subscription services has a very different
6 meaning than the concept of elasticity of
7 demand for subscription services because the
8 customer is not paying the price in the non-
9 subscription model. Correct?

10 A It is a different market
11 elasticity. It doesn't mean the concept does
12 not apply.

13 Q Well, it's true, is it not, that
14 the term elasticity would have a very
15 different meaning?

16 A It would have a different
17 application. Can I say it's a different
18 meaning? If -- I would still say it's not a
19 different meaning. It's a different
20 application. That's quibbling over words, but
21 essentially, I think that's a better way to
22 put it.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 Q Just to be clear, it's true, is it
2 not, that your analysis of the percentage of
3 revenue fee in the non-interactive market,
4 just as your analysis of the per subscriber
5 fee also depends on your assumption that the
6 ratio of the license fee to the subscription
7 price in the hypothetical non-interactive
8 market is the same as the ratio of the license
9 fee to the subscription price in the
10 interactive market?

11 A I was -- sorry. I was distracted
12 in the middle of the question. I apologize.

13 Q On page 42, if you -- make it
14 easier, I think, if you look at the third
15 sentence, fourth sentence.

16 If, as I have said, the ratio of
17 license fees to subscription price charged to
18 consumers is the same in the interactive and
19 non-interactive markets, the same percentage
20 of revenue fee would be charged in both
21 markets. I just want it to be clear that that
22 assumption is in fact a key assumption of your

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 analysis to derive the percentage of revenue
2 rate also, is it not?

3 A I'm a little confused exactly what
4 the question is different from what I've said
5 here. But I said that the same relationship
6 between subscription fees and subscription
7 prices follow, the logic follows through from
8 subscription fee recommendation through to the
9 revenue recommendation.

10 Q Let me ask my original question
11 again, and see if it's easier.

12 A I'm not trying to be difficult,
13 I'm just having a hard time --

14 Q I just want to ask if it's true
15 that your analysis of the percentage of
16 revenue fee, like your analysis of the per
17 subscriber fee, depends on your assumption
18 that the ratio of the license fee to the
19 subscription price in the target and the
20 benchmark markets is the same?

21 A Or should be the same, is what I
22 would say.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 Q Let me ask you to look at pages
2 183 and 184 of your deposition. Page 47 of
3 the transcript that I've given you. Now,
4 turning to your --

5 I asked you, at your deposition,
6 turning to your varivation of the percentage
7 of revenue fee, is it true that that
8 determination also depends on the assumption
9 that the ratio of the license fee to the
10 subscription price in the NI-DAT market is the
11 same as in the I-DAT market? And you said,
12 yes, although to clarify, it's not that it is
13 right now, but that it would be in a market
14 without a statutorily set fee.

15 Is that a correct answer?

16 A That's correct.

17 Q Okay.

18 A That's exactly what I tried to say
19 a minute ago.

20 Q Okay. And on page -- let's see.
21 Turn now to page 43 of your written testimony.
22 You state that it's your understanding that

1 under the interactive DAT contracts, under the
2 structure of the agreements that you reviewed,
3 payments are usually not made on the basis of
4 a per play rate. Correct?

5 A I recall saying that. I don't see
6 where you're pointing me to.

7 Q Okay.

8 UNIDENTIFIED SPEAKER: It's in the
9 written testimony.

10 BY MR. JOSEPH:

11 Q Oh, it's in the written testimony.
12 I'm sorry.

13 A Okay. So, I'm sorry, what page?

14 Q 43.

15 A Okay, thanks. Yes. Now, I see
16 exactly what you're referring to and yes,
17 that's what I said.

18 Q What was the source of your
19 information for that statement?

20 A The source is the testimonies of
21 the record company witnesses that I list at
22 the bottom of the paragraph.

1 Q Did you actually review the
2 payment history under the interactive
3 agreements?

4 A No.

5 Q Let me ask you to turn to page 8
6 of your testimony, written testimony. And
7 there you say that, toward the bottom, one of
8 the reasons to use your benchmark market, is
9 that there are "statistically meaningful
10 data?"

11 A Yes, sir.

12 Q And on page 12 of your testimony
13 you say that information of prices in the
14 candidate market, and I take it by that you
15 mean candidate market to be a benchmark, --

16 A Correct.

17 Q -- must be available and
18 statistically valid.

19 A Yes.

20 Q Correct? Now, by statistically
21 valid and meaningful, you mean, do you not,
22 that the dispersion of the data is relatively

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 small, as measured by such measures as
2 variants or standard deviation?

3 A I think I mean more than that. I
4 think it means that the data is clearly
5 representing the nature of marketplace
6 transactions. And, I would say also it has
7 good statistical properties that to the extent
8 that there is variation, it's either
9 explainable or it's not so great as to make
10 any statistical inferences invalid.

11 Q But one of the conditions of
12 statistically meaningful or statistically
13 valid data is that the data are -- that the
14 dispersion of the data is relatively small, as
15 measured by statistical measures. Correct?

16 A I might have put it that way at
17 one point, but I think it's better to say that
18 it's dispersion is explainable or not so
19 widespread that it makes the inferences
20 invalid. I'm just trying to be a little more
21 precise.

22 Q Well, let me ask you to look at

1 page 126 of your deposition, which is on page
2 33 of the transcript that you've got. And I
3 ask what you meant by statistically meaningful
4 data and you said then, primarily the
5 dispersion of data as measured by variant or
6 variants, I suspect is what you had said,
7 standard deviation or other measures is
8 relatively small, so you can assign pretty
9 high confidence to the averages or means.
10 Correct?

11 A Yes.

12 Q And that's what you meant, at
13 least, when I was taking your deposition.
14 Correct?

15 A I mean it know. I'm a little
16 fuller here in terms giving a broader
17 explanation.

18 Q Okay. It's possible, is it not,
19 that tightly grouped data in prices can be a
20 sign of parallelism and pricing of a kind that
21 can indicate anti-competitive behavior, isn't
22 it?

1 A It is possible.

2 Q And, Dr. Pelcovits, did you
3 perform any analysis of the probability that
4 in a competitive market where prices were set
5 wholly without reference to the other record
6 companies, every one but one of the 17
7 agreements that you looked at would have a per
8 play fee that was exactly the same?

9 A Is the question am I aware of
10 that? Yes.

11 Q No, my --

12 A I'm sorry.

13 Q -- question was, did you perform
14 any analysis of the probability --

15 A Oh, sorry.

16 Q -- that that would be so in a
17 competitive market where the prices are set
18 wholly without reference to other companies?

19 A I did not perform any analysis of
20 that. And I think, as I said, that that's
21 never the price actually paid. So, my sense
22 is it really is not telling you that much

1 about issues of parallelism of any sort or --

2 Q But it is the number that finds
3 its way into 16 of the 17 agreements, is it
4 not?

5 A Yes.

6 Q And in the other agreement, there
7 is no per play price. Correct?

8 A Correct.

9 Q Now, Dr. Pelcovits, I would ask
10 you to turn to page 48 of your written
11 statement. There you say that the claim that
12 radio promotes the sale of sound recordings
13 ignores the impact of radio on the amount of
14 time spent listening to recorded music.
15 Correct?

16 A Correct.

17 Q Did you examine quantitatively or
18 qualitatively the impact of radio listening on
19 the amount of time consumers spend listening
20 to recorded music?

21 A I did not do it. I read the
22 studies referred to here by Professor

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 Liebowitz. I did not conduct my own analysis.

2 Q You say the studies. In fact, you
3 read one paper there, correct?

4 A I cited one paper. He's written a
5 variety of papers. This is, I think, the
6 primary empirical piece that he's done.

7 Q Did you examine any information
8 about the amount of money that the record
9 companies spend to encourage radio stations to
10 play their recordings?

11 A I did not do any specific
12 analysis. I have read about that in various
13 depositions, transcripts. So, I understand
14 that there is an effort and an expenditure by
15 record companies to get and promote their
16 music at radio stations.

17 Q And you wouldn't expect record
18 companies to make those expenditures, if they
19 didn't believe those expenditures were
20 valuable to them, did you, would you?

21 A I would not.

22 Q Now, on page 49 of your written

1 testimony, you say that even if one were to
2 assume, and this is at the top of the second
3 full paragraph after third, that over-the-air
4 radio, overall, increased record sales. It's
5 an enormous unsupported leap to claim that
6 webcasting is promotional.

7 You didn't mean to say, in saying
8 that, that's it's an equally enormous leap to
9 say that internet simulcasts of radio
10 broadcasts to the same audience is
11 promotional, did you?

12 A I wouldn't say it would be to the
13 same degree a leap, the same size of a leap.
14 I think it's still something to be considered,
15 but it might not be the same if its customers
16 have a wider choice of stations to choose from
17 when they're on the internet.

18 Q That's not something you've
19 considered, though, and certainly wasn't
20 something you considered at the time of your
21 deposition, was it?

22 A That's -- I didn't consider it one

1 way or the other in this testimony.

2 Q Now, you refer to the Liebowitz
3 article. Do you recall that one of the
4 analysis Profession Liebowitz did, and I think
5 there were two empirical discussions in his
6 paper, was to review the paper surrounding the
7 introduction and growth of the radio industry
8 and its effect on the recording industry?

9 A That was one of two. The other
10 was looking at the UK where they started, for
11 the first time, to have a radio station that
12 broadcasts rock music, which was more recent.
13 But there were two studies, yes.

14 Q Let's talk about the first one
15 first.

16 A Sure.

17 Q The time period he reviewed
18 included the great depression, did it not?

19 A I recall, it's a long time ago, I
20 think it might very well have included that.

21 Q It included the introduction of
22 talking motion pictures, did it not?

1 A I expect it did, yes.

2 Q There were major differences in
3 the technology of that time than today, were
4 there not?

5 A I agree.

6 Q For example, the acoustic quality
7 of early radio was significantly better than
8 the acoustic quality of early sound
9 recordings. Do you remember him discussing
10 that?

11 A I do not recall that.

12 Q Do you remember that, in the days
13 he was looking at, sound recording lasted for
14 four minutes and then you had to flip the
15 side?

16 A I even remember those, those vinyl
17 records, yes.

18 Q And is it not true that Professor
19 Liebowitz himself says that the imprecision in
20 these data, the fluidity of the content and
21 technology, and the changing market
22 conditions, all make it impossible to have a

1 totally clear-cut test of the impact of radio
2 on the recording industry?

3 A I don't recall that, but I think
4 that's a reasonable statement, certainly for
5 the first study.

6 Q And the second study was performed
7 in Great Brittan, which you will agree is a
8 different country with a different culture?

9 A They are a different country with
10 a different culture but it's more recent and,
11 in fact, I thought it was a very nice of
12 empirical work to look at the UK.

13 Q And his conclusion, is it not, was
14 that the evidence for any effect is weak?

15 A Yes.

16 Q Now, Professor Liebowitz examined
17 the overall impact of radio on overall record
18 sales in his discussion, didn't he?

19 A Yes.

20 Q But from the standpoint of an
21 individual record company, its concern would
22 be with whether the airplay of its records

1 increased their sales. Correct?

2 A Whether the airplay of -- it could
3 really be two things. One, would lowering the
4 price of their licenses lead to increased play
5 and second, would increased play lead to
6 greater CD sales?

7 Q When we're talking about over-the-
8 air radio, we're not talking about the price
9 of licenses
10 are we?

11 A Correct.

12 Q Let me ask you to take a look at
13 page 49 to 50 of your testimony where you,
14 starting on page 49 at the bottom, you say
15 time spent listening to non-interactive
16 digital audio transmission services must be
17 coming from one of several alternative uses of
18 time, listening to CDs, listening to
19 interactive digital transmission services,
20 listening to terrestrial radio, or other
21 activities, e.g., watching TV. That's what
22 you said?

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 A Yes.

2 Q Aware you aware that a substantial
3 amount of the time spent listening to non-
4 interactive webcasting is in the office?

5 A Yes.

6 Q So, isn't it possible that a
7 substantial amount of time spent listening to
8 non-interactive webcasting is time that would
9 otherwise be spent listening to nothing, but
10 just working?

11 A I would say, again, the same type
12 of options would be there, such as listening
13 to interactive DATs or playing CDs or now we
14 have, you know, little MP3 players. So, there
15 are all sorts of options available at work, at
16 home.

17 Q Have you done any study or
18 analysis of the extent to which people play
19 CDs or listen to MP3 players in the office?

20 A I have not done any study, no.

21 Q Now, in your sensitivity analysis
22 of the affect of a decrease in CD purchases by

1 two, of a differential decrease in CD
2 purchases of two, you assume that the margin on
3 CDs is about \$5.60. Correct?

4 A Correct.

5 Q Did that margin include the value
6 of the CD sale to the record company as well
7 as the recording artist, or just to the record
8 company?

9 A It included just to the record
10 company.

11 Q Did you consider whether
12 interactive services which consist of
13 downloads may substitute more for permanent
14 digital downloads than non-interactive
15 streaming services in addition to the greater
16 substitution effect on the sale of CDs that
17 you describe in your testimony?

18 A I did not consider that as a
19 separate affect the two CDs should be, in my
20 mind, considered as a differential whether
21 it's CDs or some combination of CDs and
22 digital downloads. So, it's some other

1 purchase of recorded music.

2 Q You would agree, would you not
3 though, that the margins made by the record
4 companies on digital downloads are greater
5 than the margins made in CD sales?

6 A On a percentage basis, they are
7 larger. On an album basis, they are maybe
8 about a dollar or so higher. And, overall,
9 whether there is a greater margin or not,
10 probably is influenced a lot by how many
11 tracks of an album a customer downloads. So
12 that if a customer downloads five tracks out
13 of an album, then the margin will be lower
14 from a digital download than buying a CD.

15 Q To your knowledge, did the \$5.60
16 number that you used come from anything other
17 than the sale of physical CDs?

18 A It did not.

19 Q Now, at the bottom of page 51, you
20 say that in computing the price difference
21 caused by your assumed substitution difference
22 between interactive and non-interactive

1 markets, you assumed a linear demand curve.

2 Correct?

3 A Yes.

4 Q And, in fact, the resulting change
5 in price that's half the margin on the CD is
6 a direct result of that. Correct?

7 A Correct.

8 Q Did you perform any analysis to
9 determine the appropriate shape of the demand
10 curve?

11 A No.

12 Q In the regression analysis that
13 you spoke with Mr. Steinthal earlier, in
14 figure, in table 6.1 of your testimony on page
15 39, were there any radio simulcasting
16 services, by that I mean radio broadcasters
17 who simulcast their programming on the
18 internet, contained in that regression
19 analysis?

20 A Not as separate observations.
21 Some of them, some of the simulcasting is
22 carried by some of the pay services. So, only

1 indirect.

2 Q Do you know the extent to which
3 simulcasts were factored into this analysis?

4 A No. I can't measure that.

5 Q And you didn't take any pure
6 simulcasting services, did you?

7 A I did not take any pure simulcast
8 because there is no price to the consumer and
9 I based this on the price paid by the
10 consumer.

11 Q Is that another way of saying
12 simulcasters are non-subscription services?

13 A Yes, thank you.

14 Q In your regression analysis, one
15 of your variables, we can go back and look at
16 it if we need to, but I only have one more
17 question on it, so we'll see if we can --

18 MR. JOSEPH: -- on that, Your
19 Honor, not for the entire cross-examination.

20 BY MR. JOSEPH:

21 Q You had a variable marked quality
22 and you had a line, most of the services, in

1 fact as I recall and this is just a memory
2 test, all but one said high and one said
3 medium. Can you tell me the break point in
4 your analysis between high quality and medium
5 quality?

6 A I do not recall the breakpoint,
7 no.

8 Q Let me ask you to turn to page 12
9 of your testimony. In discussing the common
10 characteristics of the interactive and non-
11 interactive markets, your target and benchmark
12 markets, you identify, as a common
13 characteristic, the similarity of the buyers.
14 Are there any radio broadcasters in the
15 benchmark marketplace that you examined?

16 A There are none except, as I said
17 earlier, indirectly through the airage of
18 those stations by the subscription services.

19 Q And except to the extent that you
20 haven't quantified, and haven't attempted to
21 quantify, you are not aware of any radio
22 simulcasters that were direct purchasers in

1 the benchmark market, are you?

2 A Correct.

3 Q And there certainly were no radio
4 broadcasters in the 17 benchmark agreements
5 that you considered, were there?

6 A That's correct.

7 Q On page 14 of your testimony, you
8 say that music services that use the statutory
9 license often, I'm sorry, offer channels
10 targeted to particular generas, themes, or
11 subgeneras of music and that listeners can
12 select from among many subgeneras. Correct?

13 A Correct.

14 Q Now by genres, I take it, you mean
15 the dozen or so types of music that you see
16 categorized in Arbitron and other
17 publications?

18 A Yes.

19 Q And by subgeneras, you mean
20 subcategories of those genre?

21 A Yes.

22 Q Such as music specific to a time

1 period or a particular style?

2 A Yes, a style, time period, all
3 sorts of different ways of categorizing the
4 music that you see on these interactive
5 websites.

6 Q You did not examine, did you,
7 whether radio stations that simulcast their
8 programming typically provide narrow
9 subgeneras of music or more commonly provide
10 the broad genres such as those listed in
11 Arbitron and similar publications, did you?

12 A I am aware that radio stations, by
13 and large, are not as narrowly targeted as the
14 options available on the subscription
15 services.

16 Q On page 13 of your testimony, as
17 one of the similar experiences for the
18 consumer, you identify the ability, I'm sorry,
19 you identify the option to receive commercial
20 free service as important to your comparison
21 of that consumer experience for interactive
22 and non-interactive services. Correct?

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 A That's correct.

2 Q And, in fact, you believe whether
3 or not a service contained commercials in its
4 streams would be an important consideration
5 for consumers, don't you?

6 A I do.

7 Q You also believe that right now
8 it's very hard to assess or measure the
9 advertising market. Correct?

10 A I didn't say it's very hard to
11 assess it, I said that it's a very dynamic
12 market and there's -- I did not do an
13 assessment of the advertising market.

14 Q Let me ask you to look at page 202
15 of your deposition transcript, which is on
16 page 52 of the document you've got there. And
17 we were talking generally about the difference
18 between subscription services and advertising
19 services. And in your answer to my question
20 about how, let's see, how those services
21 differ, the differences change over time, you
22 said on line 14, we don't have evidence in the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 market of what it's going to look like over
2 the entire next five years, so it's very hard
3 to assess or measure the advertising market
4 right now.

5 A Yes.

6 Q And you believed that when you
7 said it?

8 A I believe it now. Whether it's --
9 one way or another, I did not assess it. I
10 think it's hard to assess and measure. I
11 still believe that now.

12 Q On recommending a rate for non-
13 subscription services, does your analysis
14 consider how the music quality of those
15 services compare to the music quality of
16 subscription services?

17 A It does not. It does not set any
18 different in rate based on the quality of the
19 broadcast that the subscription or non-
20 subscription webcaster would use.

21 Q And in recommending a rate for
22 non-subscription services, you didn't consider

1 the number of channels or streams offered by
2 non-subscription services, compared to
3 subscription services, did you?

4 A That's true.

5 Q And you'd expect the number of
6 channels or streams to be important to
7 consumers when they value a service, wouldn't
8 you?

9 A Yes.

10 MR. JOSEPH: May I have a moment,
11 Your Honor?

12 Thank you, Dr. Pelcovits. Thank
13 you, your Honor, I have no further questions.

14 CHIEF JUDGE SLEDGE: Ms. Brown,
15 any cross-examination?

16 While we transition, why don't we
17 take a ten minute recess?

18 (Whereupon, the foregoing matter
19 went off the record at 3:18 p.m. and went back
20 on the record at 3:30 p.m.)

21 CHIEF JUDGE SLEDGE: Thank you.
22 We will come to order.

1 Ms. Brown?

2 BY MS. BROWN:

3 Q Good afternoon, Dr. Pelcovits,
4 Kris Brown on behalf of NPR.

5 A Good afternoon.

6 Q I'd like to draw your attention to
7 page 5 of your testimony, written testimony.
8 At the bottom of the page, in the last
9 paragraph, you state I also assume that both
10 the willing buyer and willing seller in this
11 hypothetical marketplace are commercial
12 entities fully motivated to maximize profits.
13 And then you go on, on page 6 to say thus,
14 I do not attempt to set separate rates for
15 noncommercial entities or hobbyists that are
16 not seeking to maximize profit or even those
17 small webcasters that may be unable to survive
18 without the benefit of a below market
19 statutory license.

20 A Yes, I see that.

21 Q Okay. So I just want to clarify,
22 you never made any attempt to derive a rate

1 for noncommercial entities, including National
2 Public Radio in your analysis. Is that
3 correct?

4 A I did not try to derive a separate
5 rate for those entities, no.

6 Q Okay. But you would agree,
7 wouldn't you, that the statutory standard does
8 not preclude setting a rate for public
9 broadcasting and non-commercial entities,
10 isn't that correct?

11 A To my best recollection, that's
12 correct.

13 Q Okay. And do -- you agree, don't
14 you, that the buyers, the willing buyers, as
15 you conceptualize them, are not comparable as
16 between public broadcasters and commercial
17 webcasters, isn't that correct?

18 A I'd agree with that.

19 Q And would you agree that it's
20 possible that a willing seller might have an
21 interest in setting more than one rate if
22 market segmentation of the consumers were

1 possible?

2 A If it would be a segmentation that
3 would segment consumers, yes, but not
4 necessarily of producers selling to the same
5 consumers.

6 MS. BROWN: Okay. No further
7 questions.

8 CHIEF JUDGE SLEDGE: Mr. Malone,
9 would you like to inquire?

10 BY MR. MALONE:

11 Q Good afternoon, Dr. Pelcovits.

12 This morning, Mr. Joseph was
13 asking you in the anti-trust context about
14 interactive licenses and, as I caught it, your
15 testimony was that interactive licenses were
16 "one of the many markets in which sound
17 recordings are provided" and then you went on
18 to say that record companies use multiple
19 channels to distribute these products. And
20 would you consider these to be examples of
21 market segmentation?

22 A Not in the sense of the question I

1 just answered from Ms. Brown. Market
2 segmentation can mean simply markets that are
3 different based on the characteristics of the
4 supply side and, namely, you can provide
5 something in one channel using a variety of
6 different techniques of delivering it, let's
7 say, how you get it to the car versus how you
8 get it to the home? It can also be, from a
9 demand side, you're going to try to segment
10 consumers in a way to maximize profits.

11 Q But -- let's see if I can build on
12 that. Consider the analogy to private
13 labeling in the grocery store and Dole
14 provides certain fruits under the Dole label
15 and they also provide certain fruits under the
16 Giant label and these sell to the consumer at
17 different prices. And Dole receives different
18 prices from the grocery store, does it not?

19 A I don't know that for a fact but -
20 -

21 Q Well --

22 A -- I'll carry that forward, carry

1 the assumption --

2 Q All right.

3 A -- forward is fine for me.

4 Q So, in this case, the hypothesis,
5 the pineapple, fruit, whatever it is, is the
6 same in both the cans and it's merely the
7 wrapping that is different?

8 A Sure.

9 Q And so, --

10 CHIEF JUDGE SLEDGE: Well, that's
11 another assumption you make.

12 MR. MALONE: Well, --

13 CHIEF JUDGE SLEDGE: That Dole
14 sells the same fruit under two different
15 labels.

16 MR. MALONE: Let's ask the witness
17 if he knows.

18 CHIEF JUDGE SLEDGE: Well, he's
19 already says he doesn't know.

20 MR. MALONE: I didn't understand
21 him to indicate that, Your Honor.

22 CHIEF JUDGE SLEDGE: Oh, I'm

1 sorry.

2 THE WITNESS: I was accepting that
3 as an assumption, --

4 MR. MALONE: I see.

5 THE WITNESS: -- quite frankly. I
6 was not testifying --

7 MR. MALONE: I see.

8 THE WITNESS: -- as a pineapple
9 expert.

10 (Laughter.)

11 BY MR. MALONE:

12 Q But from your experience in the
13 economics business, there are examples of
14 private labeling where the product is
15 precisely the same?

16 A I'd expect there are.

17 Q And, but again, the manufacturer
18 in that case is after profit maximization?

19 A Yes.

20 Q Looking to page 45 of your
21 testimony, about the middle of the page in the
22 paragraph that begins Live365 reports, you say

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 that you have assumed an average of 15.5 plays
2 per hour. I don't find any other discussion
3 of that numerical value elsewhere in your
4 testimony and I'm asking where it comes from?

5 A I believe I used the conversion
6 ratio that currently converts plays to the
7 hourly fees under the statutory license.
8 There but -- I would think it comes pretty
9 close to what the number of plays are in a
10 subscription service.

11 Q All right. Assuming for a moment
12 that's correct, did you do any analysis or
13 investigation as to whether the 15.5 is
14 applicable across the webcasting industry as
15 a whole? I mean, what's the range here that
16 we're really working with?

17 A I would suspect the range, if
18 we're including commercials networks as well
19 as noncommercial networks, that it would be
20 below 15.5 for the commercial networks and
21 15.5 might in fact be about where it is for
22 the subscription networks?

1 Q And then you mentioned
2 noncommercial and I didn't understand where
3 you put that.

4 A I didn't. I must have been
5 mistaken. What I meant the distinction
6 between subscription and non-subscription.
7 So, I expect that the non-subscription
8 commercial by their meaning it has
9 commercials, in non-subscription market, the
10 non-subscription webcasts supported by
11 commercials, that those would tend to have
12 fewer plays than the subscription market which
13 does not have commercials because of the time
14 and the hour that it's being used by the
15 commercials, leaving less time for music.

16 Q But you didn't make any actual
17 measurements as to noncommercial simulcasts,
18 that is, simulcast by noncommercial
19 broadcasters?

20 A I did not make an assessment of
21 that, correct.

22 Q And you have no data then on that

1 point at all?

2 A I have not looked at any data on
3 that.

4 Q And to what extent does this 15.5
5 plays per hour, what's the sensitivity
6 analysis on that figure?

7 A It's directly -- I mean, it's a
8 direct mathematical relationship if it's -- if
9 the number of plays were higher, and we were
10 to continue with the assumption of 45 hours
11 per month, then, for example, if there were 20
12 plays, you would get 900 plays per month and
13 you'd divide 900 into the monthly fee, the
14 \$1.63 and get the resulting per play fee of
15 \$1.63 divided by 900. So --

16 Q So the only place you use the 15.5
17 is in connection with attributing a per play
18 value based on a subscription service?

19 A Well, it's based on the
20 assumptions as stated here, which I did -- I
21 was not even trying to capture exactly what's
22 going on in the market because, as I said, the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 Live365 claims 32 hours per month and I
2 grossed that up quite a bit. So, it's an
3 attempt to try to give what I believe is a
4 reasonable and conservative number. It's not
5 scientifically pegged to a specific type or
6 use of webcasting.

7 Q But in fact the 32 hours per month
8 may have no particular applicability to
9 certain types of simulcast?

10 A It might not..

11 MR. MALONE: I think I have no
12 further questions.

13 CHIEF JUDGE SLEDGE: Mr.
14 Freundlich, I believe, has left. He was here
15 earlier. Have everyone had their opportunity
16 to cross-examine?

17 (No response.)

18 CHIEF JUDGE SLEDGE: All right,
19 thank you. Any redirect Mr. Handzo?

20 MR. HANDZO: Yes, Your Honor, if I
21 might just have a minute to collect my notes,
22 --

1 CHIEF JUDGE SLEDGE: Certainly.

2 MR. HANDZO: -- I would appreciate
3 it.

4 MR. JOSEPH: Your Honor, while Mr.
5 Handzo is collecting, I do have a housekeeping
6 question, actually. Are we expecting Mr.
7 Simson to come over or are we -- I need to
8 make appropriate arrangements, if we are. I'm
9 just not sure.

10 MR. HANDZO: Well, we're actually
11 sort of in email contact as we speak. When we
12 had -- I guess my sense would be, between the
13 redirect and what I would expect to be
14 recross, I would expect that we would eat up
15 enough of the rest of our small remaining time
16 that it didn't make sense to bring him.

17 MR. JOSEPH: I don't object to
18 that, Your Honor, I just wanted to know
19 whether I needed to have people come over.

20 CHIEF JUDGE SLEDGE: That seems
21 very unlikely.

22 MR. JOSEPH: Okay.

1 CHIEF JUDGE SLEDGE: Why don't we
2 just go ahead and secure that possibility.
3 That doesn't make any sense for me to -- it
4 would take you that long to get through
5 security.

6 MR. JOSEPH: Thank you, Your
7 Honor.

8 (Laughter.)

9 REDIRECT EXAMINATION

10 BY MR. HANDZO:

11 Q Good afternoon, again, Dr.
12 Pelcovits.

13 A Good afternoon, Mr. Handzo.

14 Q Dr. Pelcovits, when you were
15 testifying yesterday, you were asked whether
16 you made an adjustment in your benchmark with
17 respect to tethered downloads. Do you recall
18 that?

19 A I do.

20 Q Okay. And would you remind us
21 what tethered downloads are?

22 A Sure. Tethered downloads that are

1 obtained from the subscription webcast service
2 by the subscribing customer. They are
3 downloaded to the computer and they are
4 essentially like a mission impossible kind of
5 tape. They will magically erase themselves if
6 you end your subscription to the service. And
7 there's also a mechanism for tracking how many
8 plays are made of the music on the person's
9 computer when they're offline as well as
10 online.

11 Q Now, as I understand it, under
12 certain circumstances, you know, some services
13 might allow you to transfer that tether
14 download to a portable device. Is that
15 correct?

16 A Yes, that's correct, usually at an
17 additional fee.

18 Q Okay. And so where there could be
19 a transfer to a portable device, am I right
20 that you didn't include those services when
21 you determined your benchmark?

22 A When I determined my benchmark and

1 developed this 0.55 adjustment factor, that's
2 correct.

3 Q Okay. So, what we're talking
4 about in terms of adjustment is tethered
5 downloads that cannot be put onto a portable
6 device?

7 A That's correct.

8 Q All right. Now, with respect to
9 those kinds of tethered downloads, do you
10 recall reading the testimony of Mr. Roback of
11 Yahoo with respect to services that Yahoo
12 offers that have both tethered capability and
13 non-tethered capability?

14 A I don't recall his testimony. I
15 do know that Yahoo provides, as part of its
16 Yahoo music service, tethered downloads as
17 part and parcel of the music service that it
18 offers on subscription basis.

19 Q All right. Let me see if I can
20 refresh your recollection here. I'm going to
21 mark this as SoundExchange Exhibit 276 DP,
22 just to continue with our number system.

(Whereupon, the document
referred to as
SoundExchange Exhibit No.
276 DP was marked
for identification.)

BY MR. HANDZO:

Q Have you had a chance to review
that?

A I have.

Q And do you see where Mr. Roback
says that MusicMatch on-demand has one version
where you can get conditional tethered
downloads?

A I see that.

Q Okay. And you see that Yahoo does
not charge any more for that capability?

A Yes.

Q Does that affect your opinion as
to whether you would need to adjust for
tethered downloads?

A I think I said earlier there is an
implicit adjustment, there's not an

1 adjustment, but this value to the -- the
2 potential value to the consumer of tethered
3 downloads is included in the overall
4 adjustment I make. And, specifically with
5 respect to MusicMatch and, I think, across the
6 market, these tethered downloads are becoming,
7 they're at a normal feature of the
8 subscription music services.

9 Q Okay. So, it's already been
10 adjusted for, in effect?

11 A It has already been adjusted for.

12 Q All right. Now, you also said
13 that you didn't make a separate adjustment for
14 bit rates or sound quality?

15 A That's correct.

16 Q Can you explain to us why you
17 didn't do that?

18 A I did not make a separate
19 adjustment for bit quality because there is
20 nothing under the statute that restricts the
21 bit rate for the statutory webcasts to be
22 anything different than what it is for the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 interactive services. It's up to the
2 webcaster what bit rate to provide the service
3 at and, if that's up to the webcaster, then
4 the record labels would expect to charge a
5 single rate rather than make an adjustment
6 based on what webcasters might have done in
7 the past or whatever happens to be in the
8 market right now.

9 Q You also testified that you didn't
10 make a separate adjustment for the number of
11 channels offered by a given webcaster. Again,
12 why not?

13 A For the same reason that it's up
14 to the webcaster what type of service to try
15 to put together and sell in the market. And
16 under the statutory license, they can provide
17 whatever type of service in terms of number of
18 channels, how narrowly targeted the channels
19 are to consumers and sell that in the market.
20 And that, I believe, since it's up to the
21 webcaster how to use this music subject to the
22 restrictions in the statute, that it shouldn't

1 have a separate adjustment between the
2 interactive market and the non-interactive
3 market.

4 Q Now, you also have some questions
5 about the fact that you used as your benchmark
6 subscription services and whether that sort of
7 model is then applicable to ad supported
8 services.

9 The first question, I guess, is,
10 let's assume for the sake of argument that the
11 revenues for ad supported services were
12 different than the revenues for subscription
13 services. Would that have any impact on the
14 percentage of revenue component of your
15 proposed fee?

16 A Well that would, that would not --
17 that would actually lead to less being paid
18 where there is less revenue being collected.

19 Q So the percentage of revenue fee
20 is in effect, self-adjusting?

21 A It's self-adjusting where there is
22 no subscription fee or alternatively, where

1 the per play rate doesn't also come into the
2 market.

3 Q So, in terms of the application of
4 your model to an ad supported service, the per
5 subscriber rate is not relevant because there
6 are no subscribers. Correct?

7 A Right.

8 Q And the percentage of revenue is,
9 in effect, self-adjusting?

10 A Correct.

11 Q And so what we're really talking
12 about here is the per play rate?

13 A Yes.

14 Q Now, in your view, Dr. Pelcovits,
15 would record companies be able to
16 differentially price with respect to the per
17 play rate as between ad supported services and
18 subscription supported services?

19 A Under the statute -- I mean, it
20 depends on how the statutes is actually and
21 how the Court rules.

22 Q Well, let me put it this way. I

1 guess I'm not asking as a legal matter. Is a
2 willing seller going to want to price
3 differently between the two?

4 A Not necessarily. Not without a
5 very compelling evidence that that was going
6 to increase their revenues, rather than
7 decrease their revenues. So, so long as there
8 is a certain degree of consumer
9 substitutability between non-subscription and
10 subscription services, the record companies
11 would be putting their revenues at risk if
12 they tried to set a lower rate for the
13 subscription services, I'm sorry, for the non-
14 subscription services and the subscription
15 services.

16 Q And they would be putting their
17 revenues at risk, why?

18 A Because the lower, the lower
19 price, namely, if the lower prices for non-
20 subscription services would yield a
21 potentially better deal for consumers and
22 consumers would use those rather than

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 subscription services, so I mean, the term is
2 cannibalization but it's essentially
3 substitutability on the consumption side for
4 the two services and low prices drive out high
5 prices.

6 Q Now you were asked some questions
7 recently by Mr. Joseph about assuming that
8 there were certain prices in the market for a
9 subscription interactive service and a
10 subscription non-interactive service. I think
11 the numbers he used were \$6 and \$8 and then he
12 asked you what would happen if you changed the
13 fee. Do you recall that?

14 Now, in your view, if the fee
15 charged by the record companies in the non-
16 interactive market changed, would that change
17 the price to consumers?

18 A I expect it would, yes.

19 Q Okay. So, there would simply be a
20 new equilibrium reached there?

21 A There would be a new equilibrium
22 reached.

1 Q Let me ask you to look at page 51
2 of your testimony. And down towards the
3 bottom, you talked about your assumption of a
4 linear demand curve. Do you see that?

5 A I do.

6 Q And you characterized it as a
7 neutral assumption. Do you see that?

8 A Yes.

9 Q Can you tell us why?

10 A Yes. It's neutral because the
11 effect of a price change on the quantity
12 demanded can be more pronounced or less
13 pronounced than what is indicated by the
14 linear demand curve. So, that's why I called
15 it a neutral assumption. It's a very standard
16 in economics to give you a result where you
17 don't have the wealth of data you would need
18 to try to estimate a specific form of the
19 demand curve.

20 Q In other words, a different
21 assumption might have favored the webcasters?

22 A It could go either way.

1 Q Okay. You were asked some
2 questions, I think this morning, by Mr.
3 Steinthal, who was positing that the prices
4 charged to consumers in the interactive market
5 might be set artificially low by the
6 webcasters because they wanted to build an
7 audience. Do you recall that?

8 A Yes.

9 Q Okay. Now, when you derived your
10 rate in this case, you were using a ratio
11 between the fee charged by the record
12 companies and the price charged to consumers.
13 Do you recall that?

14 A Yes.

15 Q And that ratio was based on the
16 ratio in the interactive benchmark market. Is
17 that correct?

18 A Correct.

19 Q Okay. Now, if the price to
20 consumers were to go up such that the
21 percentage of revenue component of the fee
22 became the operative fee, would the increase

1 in consumer price change the ratio?

2 A No, it wouldn't.

3 Q Why is that?

4 A The nature of percentages that if
5 you're charging, let's say, 40 percent of a
6 price, then the ratio's going to be 0.4. It
7 doesn't matter where the price is.

8 Q Okay. So, if Mr. Steinthal were
9 correct and the consumer price went up, that
10 wouldn't change the ratio on what which you
11 based your analysis?

12 A No. It would not change the ratio
13 based on a percentage of revenue portion of
14 the fee structure.

15 MR. STEINTHAL: Your Honor, I'm
16 not sure what ratio he's referring to. So, my
17 objection is to the question insofar as I'm
18 not sure what ratio, of all the ratios that
19 have been talked about, the witness is
20 referring to.

21 CHIEF JUDGE SLEDGE: Is that a
22 proper objection?

1 MR. STEINTHAL: Well, I hope so.

2 (Laughter.)

3 CHIEF JUDGE SLEDGE: I think
4 that's more a question for your next time to
5 examine.

6 MR. STEINTHAL: Okay.

7 MR. HANDZO: Let me -- I'm happy
8 to try and clarify it because --

9 CHIEF JUDGE SLEDGE: You may
10 oppose Mr. Handzo.

11 MR. HANDZO: At this point, I can
12 use all the help I can get.

13 BY MR. HANDZO:

14 Q The ratio that we were just
15 talking about, is that the ratio between the
16 fee charged by record companies in the
17 interactive market and the price charged to
18 consumers in the interactive market?

19 A Yes.

20 Q Okay.

21 MR. STEINTHAL: I'm glad he
22 clarified that.

1 BY MR. HANDZO:

2 Q Dr. Pelcovits, let me ask you to
3 take a look at The Services Exhibit 62, which
4 is the Arbitron study.

5 A I have that now.

6 Q Okay. And I believe Mr. Steinthal
7 directed your attention to paragraph 25 on
8 page 14?

9 A Yes, I believe.

10 Q And correct me if I'm wrong, but I
11 think what you indicated there was the fact
12 that there might be a correlation between
13 streaming and CD purchases did not mean that
14 there was a causal effect between the two?

15 A Yes.

16 Q Let me ask you to take a look at
17 the next paragraph, paragraph 26.

18 A I see that.

19 Q All right. And do you see that
20 that reports that people who stream see more
21 movies?

22 A Yes.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 Q What does that -- does that affect
2 your opinion about whether there's a
3 correlation or causation here?

4 A I think it's a good example of a
5 correlation and --

6 Q Rather than causation?

7 A -- it's showing the danger of
8 drawing conclusions about causation from
9 correlations.

10 Q Dr. Pelcovits, do you have any
11 experience with consumer surveys that attempt
12 to get consumers to either predict or report
13 the level of their consumption of goods or
14 services?

15 A I do.

16 Q Tell us what that experience is?

17 MR. STEINTHAL: Your Honor, this
18 is -- I object. I believe this is beyond the
19 scope of our cross-examination. This witness
20 is experienced in surveys.

21 CHIEF JUDGE SLEDGE: On that
22 objection, with the examination involving such

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 a survey, the subject Exhibit 62 is overruled.

2 THE WITNESS: I do have experience
3 with quite a lot of surveying that was done in
4 the telecommunications industry. And I would
5 say that, as a general matter, surveys are not
6 very good at obtaining estimates from
7 consumers of sort of how many things they buy
8 and how much they spend. And that the
9 industry, the telecommunications industry,
10 certainly relied much more on data that was
11 obtained from customer bills rather than
12 anything from surveys.

13 BY MR. HANDZO:

14 Q Now, you mentioned in response to
15 one of --

16 MR. JOSEPH: Just a point of
17 clarification, whose surveys would you be
18 referring to there? Surveys done by the
19 industry or a wider group of surveys?

20 THE WITNESS: This would really be
21 both, that either conducted internally or
22 conducted by an outside party.

1 MR. JOSEPH: And including
2 government surveys?

3 THE WITNESS: I'm sorry, I didn't
4 --

5 MR. JOSEPH: Including government
6 surveys?

7 THE WITNESS: I don't have
8 knowledge of surveys by the government asking
9 people how much they spend in specific, very
10 specific, industries. So, I can't say.

11 MR. JOSEPH: Okay. I just wanted
12 to clarify which surveys we were talking
13 about.

14 BY MR. HANDZO:

15 Q You mentioned in response to one
16 of Mr. Steinthal's questions that you actually
17 looked at the overall shipments of CDs in the
18 U.S.?

19 A I did.

20 Q Can you tell us what you found
21 when you did that?

22 A I did. I found that the average

1 number of CDs purchased per person in the
2 United States is far lower than indicated from
3 the survey here. This indicates an average
4 American purchases 13 CDs in the past year and
5 I recall a later Arbitron study showing ten
6 CDs a year. If you take CD shipments which
7 are approximately 700,000,000, which is public
8 RIAA data and divide it by, if not the entire
9 population, the populations say of all of a
10 certain age, age ten or so, you're going to
11 get about three and a half CDs as the average
12 number of CDs purchased per person.

13 And that would indicate that
14 customers responding to the survey are
15 overestimating what they're spending or that
16 their survey is not very representative of the
17 population.

18 MR. HANDZO: May I just have a
19 moment, Your Honor?

20 CHIEF JUDGE SLEDGE: That's fine.

21 MR. HANDZO: I believe that's all
22 I have.

1 CHIEF JUDGE SLEDGE: Mr.

2 Steinthal, any recross?

3 MR. STEINTHAL: Just briefly, Your
4 Honor.

5 RECROSS-EXAMINATION

6 BY MR. STEINTHAL:

7 Q Dr. Pelcovits, first of all, on
8 this issues of subscription, non-subscription
9 and pricing at the higher value use versus not
10 pricing at the higher value use and avoiding
11 cannibalization, that general subject that's
12 come up, let me ask you this question.

13 Assume if you will,
14 hypothetically, that ten percent of the demand
15 in a market is willing to pay nine units per
16 good for a certain good. Okay?

17 A Okay.

18 Q And assume 90 percent of the
19 market demand is not willing to pay, directly
20 or indirectly, more than 1.1 units for the
21 same good. Wouldn't you agree with me that a
22 profit maximizing seller, if it had to choose

1 between selling to the highest value user at
2 nine units for ten percent of the demand and
3 the 90 percent of the market willing to pay
4 1.1 unit, they'd be better off selling to the
5 90 percent of the market?

6 A No, because that presumes. I can
7 do the math, too. Your math would show you'd
8 get 90 units of currency from the ten percent
9 versus 99 units of currency from the 90
10 percent of the demand and, therefore, it would
11 appear, based on your example, to suggest that
12 you're better off setting a price of 1.1. But
13 that assumes that what you observe in the
14 market by a 10 percent/90 percent breakdown is
15 itself going to stay the same. If you were to
16 only offer the \$9 price.

17 Q Well, hypothetically, it is going
18 to stay the same. If that's the assumption
19 and you have no evidence upon which to assume
20 that the consumers are going to change their
21 behavior from that assumption, the profit
22 maximizing seller would sell to the 90 percent

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 of the market. Right?

2 A If you make all of those
3 assumptions, yes.

4 Q Okay. Now, the ratio question.

5 A Oh, no.

6 Q I need to put this back up, just
7 to clarify something because now I know why I
8 was confused. Because I was thinking about a
9 different ratio than the one that you were
10 testifying about. I just want to confirm
11 that.

12 Back to 6.2. Let's focus on line
13 3 of each of those entries on 6.2. That
14 refers to a ratio, does it not?

15 A It does.

16 Q And that's not the ratio you were
17 addressing in responding to Mr. Handzo.
18 Correct?

19 A That's correct.

20 Q And it's true, is it not, and I
21 think we went over this when I asked a
22 question, which is to clarify, if the monthly

1 price paid by the benchmark market interactive
2 services increased, the ratio would decrease.
3 So you'd go from a ratio of one to two,
4 perhaps to one to three, or one to four,
5 depending on just how high that price for the
6 benchmark market service went up. Correct?

7 A Yes.

8 Q And hypothetically, the lower
9 those ratios are, the lower the resulting
10 price, in your model. Correct? For the non-
11 interactive target market service?

12 A For the non-interactive target
13 services that I calculated to be \$4.56, yes.
14 That would be a lower number.

15 Q Okay. Now the testimony you gave
16 about surveys?

17 A Yes.

18 Q First of all, in your experience
19 as an economist, I gather you have relied upon
20 some surveys in your experience?

21 A I have.

22 Q And without reviewing the

1 underlying specifics in terms of who has been
2 surveyed and what the parameters are, I gather
3 you would just be uncomfortable giving any
4 testimony about whether a given survey is a
5 good one or a bad one?

6 A Unless I knew the organization
7 that performed it.

8 Q And by the way, you gave some
9 testimony about the CD sales or shipments.
10 First of all, were you referring to sales or
11 were you referring to shipments?

12 A I don't recall how the RIAA
13 reports which of the two is reporting.

14 Q And it's fair to say that what you
15 were testifying to is that you had come across
16 certain data that you were recalling, but it's
17 true that you didn't do any analysis of the
18 sales and shipments data of the recording
19 industry as part of your engagement here?

20 A I reviewed a lot of statistics. I
21 did not compute them or examine the underlying
22 data. That is publicly reported by RIAA every

1 year and it's reported on their website and
2 downloaded and that's the number I was talking
3 about.

4 MR. STEINTHAL: One second, Your
5 Honor. I have no further questions, Your
6 Honor.

7 CHIEF JUDGE SLEDGE: Mr. Joseph,
8 any further questions?

9 MR. JOSEPH: No further questions,
10 Your Honor.

11 CHIEF JUDGE SLEDGE: Ms. Brown?

12 MS. BROWN: No further questions,
13 Your Honor.

14 CHIEF JUDGE SLEDGE: And Mr.
15 Malone?

16 MR. MALONE: Yes, please, Your
17 Honor.

18 CHIEF JUDGE SLEDGE: All right.

19 BY MR. MALONE:

20 Q Dr. Pelcovits, I was a little bit
21 confused by your arithmetic computations in
22 response to Mr. Steintal's hypothesis

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 concerning ten percent of the market being
2 nine units and that 90 percent of the market
3 paying 1.1 unit. And I understood your answer
4 to be that if the seller priced the 90 percent
5 of the market, he would get 99 percent or 99
6 units.

7 Is it not true, however, that the
8 ten percent of the market would also purchase
9 at the lower price?

10 A It very well might.

11 Q So even that event would get 100
12 percent of the market?

13 A Well, you get 100 percent of the
14 market in either case, once you have a single
15 price. It's a question of in which price
16 times which quantity gives you more money.

17 Q All right. Let me ask the
18 question then a little more carefully.

19 MR. HANDZO: I'm sorry. I feel
20 some need to interpose an objection here. I'm
21 not sure it's appropriate to recross on
22 somebody else's recross. He can recross on my

1 redirect, but not Mr. Steinthal's recross.

2 CHIEF JUDGE SLEDGE: Well, we'll
3 give Mr. Malone a little leeway.

4 MR. MALONE: I think we're one
5 question away, Mr. Handzo.

6 MR. HANDZO: I'm sorry I held it
7 up then.

8 BY MR. MALONE:

9 Q So, in terms of units, what would
10 the seller in that case be bringing in the
11 door at the lower price?

12 A Well, can we use -- I'll call the
13 units dollars --

14 Q You may.

15 A -- United States dollars. So, in
16 which case, if you set a price at \$1.10 and
17 you sold, previously you were selling ten
18 units in the high end, 90 units in the lower
19 end, you'd now be selling 100 units at \$1.10,
20 so you'd get \$110.

21 Q So, the incentive for the lower
22 price would be slightly greater than your

1 original answer?

2 A The -- yes, the money you would
3 get is greater than what I previously
4 indicated. You're right.

5 Q And the profit maximizing seller
6 would choose the larger number, I take it?

7 A Well, he'd hopefully do the math
8 right and he'd choose between \$110 and \$9
9 times however many units would have been sold
10 in the market, should the \$9 commodity be the
11 only thing available.

12 CHIEF JUDGE SLEDGE: All right.
13 That seems to conclude the examination of Dr.
14 Pelcovits.

15 The parties present couldn't
16 appreciate the phenomena that as soon as we
17 determined, about 15 minutes ago, that we were
18 going to finish earlier than expected, there
19 were, the attitude of this room significantly
20 improved.

21 (Laughter.)

22 CHIEF JUDGE SLEDGE: That's the

1 first time I've seen smiles on people's faces
2 in a couple of days. It's been quite
3 refreshing.

4 That completing the evidence
5 today, anything to address before we adjourn?

6 MR. HANDZO: Only, Your Honor,
7 that I have just been handed SoundExchange's
8 response to RLI's motion requesting referral
9 of material questions of substantive law,
10 which I understand has been filed. So again,
11 if the Court would like courtesy copies, I can
12 distribute those.

13 CHIEF JUDGE SLEDGE: No, thank
14 you.

15 MR. HANDZO: Okay.

16 CHIEF JUDGE SLEDGE: All right. I
17 have omitted a critical part of our day. I
18 hope it doesn't affect the mood of the room.

19 Any question from the bench to Dr.
20 Pelcovits?

21 JUDGE ROBERTS: Mr. Pelcovits, if
22 I'm correct, you testified earlier that, in

1 your determination, the rate that the CARP set
2 in 2002 was a below market value rate. Is
3 that correct?

4 THE WITNESS: Yes. I said, as we
5 see right now. I didn't try to judge the
6 market of 2002, but I believe it's below what
7 the willing buyer and willing seller would pay
8 now.

9 JUDGE ROBERTS: In the current
10 market?

11 THE WITNESS: In the current
12 market.

13 JUDGE ROBERTS: And, therefore, I
14 take it that means you did not seek to apply
15 your model to any data from 2001 or 2002 as to
16 whether the CARP got it right at that point in
17 time?

18 THE WITNESS: That's correct.

19 JUDGE ROBERT: Do you have any
20 view as to whether the CARP got it right in
21 2002?

22 THE WITNESS: No, I don't. I have

1 not tried to look at it from that perspective.

2 JUDGE ROBERTS: Thank you. That's
3 all.

4 CHIEF JUDGE SLEDGE: Judge
5 Wisniewski?

6 JUDGE WISNIEWSKI: Just a couple
7 of questions.

8 Dr. Pelcovits, we've been talking
9 a lot about demand curves in this proceeding
10 so we haven't really said a whole lot about
11 the supply curves, the underlying supply
12 curves.

13 I wonder if you can tell me what
14 you think the shape of the supply curve is in
15 the ultimate output market here, the consumer
16 market that you talked about? And then, also,
17 the supply curve or the shape of the supply
18 curve in the input market that you talked
19 about?

20 THE WITNESS: I'll be happy to
21 address that. I think in the output market,
22 it is a very elastic supply. The factors of

1 production, other than the input we're talking
2 about, the music are readily available, easily
3 reproducible and can accommodate significant
4 increases in supply without an increase in
5 price.

6 I think with respect to the music,
7 they're really, with respect to the music that
8 is already created, there really is no change
9 in the traditional sense of more of that being
10 recreated. Essentially, it's a license and
11 actually, from the standpoint of supply of
12 more licenses, if there was no copyright
13 owner, it would be again, infinitely elastic
14 supply. So, we're really, -- what happens in
15 the market is --

16 JUDGE WISNIEWSKI: Wait, let me
17 catch up. What did you say?

18 THE WITNESS: Infinitely elastic
19 supply.

JUDGE WISNIEWSKI: With
20 respect to?

21 THE WITNESS: With respect to
22 licenses. Licenses are, essentially, are just

1 a permission. So, if there was multiple
2 competing providers of a copyright license to
3 the same sound recording, I would say it would
4 command a zero price. And you could provide
5 infinite amounts of it at a zero price.

6 JUDGE WISNIEWSKI: So, you're
7 looking at it, the product being supplied, as
8 being a license that is somehow unlimited in
9 terms of what it can deliver. Is that what
10 you're saying?

11 THE WITNESS: That's how I'd look
12 at the issue of supply, in a traditional sense
13 of looking at supply. If what we're
14 considering is the copyrighted music, as the
15 law stands that only the copyright owner can
16 offer more of it, it's really not a
17 traditional supply curve. It's a profit
18 maximization calculation that the supplier
19 undertakes. So, it's not as if you can say
20 what the price will be at any particular level
21 of output, because that depends on -- it's not
22 an intersection, strictly speaking, of a

1 demand and supply curve, it's an intersection
2 of a demand curve and a profit maximization
3 calculation by the supplier. JUDGE WISNIEWSKI:
4 Well, if we have a blanket license, doesn't
5 that actually fix the supply over the term of
6 the contract?

7 THE WITNESS: I don't think I put
8 it that way. I think the supply might be,
9 the supply here, -- I sort of see the market
10 as, if we're thinking of sort of the quantity
11 as being the number of subscribers to these
12 different services, or the number of times the
13 music is listened to, or something of that
14 nature, there's really no cost associated from
15 the copyright owner's standpoint. No physical
16 costs. There are opportunity costs, but there
17 is no actual production costs of having that
18 music played again, again, and again by as
19 many subscribers as possible.

20 JUDGE WISNIEWSKI: So then, if I
21 could pursue this just a bit further. If I
22 can try and understand what you're saying

1 here.

2 The supply wouldn't be fixed
3 because even though the number of sound
4 recordings might be fixed, the number of times
5 that they could be played is infinitesimal or
6 infinite, I should say?

7 THE WITNESS: Yes. Yes. And also
8 with respect to the number of sound
9 recordings, there are new ones being produced
10 all the time, so there is some supply,
11 traditional sort of supply, curve in that
12 market.

13 JUDGE WISNIEWSKI: So, from an
14 endpoint of view, it's not actually the sound
15 recordings but the number of times that they
16 could be played?

17 THE WITNESS: That's the way that
18 I've tried to analyze it with respect to this
19 market for the blanket license, yes.

20 JUDGE WISNIEWSKI: Okay. I'm just
21 trying to get a handle on that, from your
22 perspective.

1 The -- I guess part of that, you
2 had, in your testimony, talked about a change
3 in the copyright fee being passed along to the
4 consumer dollar for dollar. Does that
5 actually result then in the typical fashion in
6 which you would apply, for example, a tax,
7 which would represent a shift in the supply
8 curve?

9 THE WITNESS: Yes.

10 JUDGE WISNIEWSKI: I guess the
11 last couple of questions that I have here
12 relate back to your regression in table 6.1.
13 Page 39 of your testimony.

14 THE WITNESS: Thank you, very
15 much. I've got it.

16 JUDGE WISNIEWSKI: I wonder if you
17 could, at the risk of altering the mood in the
18 room, I wonder if you could take us through
19 each of the arguments in your specification
20 here and tell us a couple of things about
21 them?

22 One, I'll give them to you all in

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 a lump so that you can -- one is, which of the
2 arguments ultimately proved significant and at
3 what level, at what confidence level?

4 Secondly, if you could tell me
5 what the source data was for each of the
6 variables?

7 And third, if you could tell me,
8 theoretically, as to how they fit together?
9 Why you chose the variables you chose in this
10 specification as opposed to some other group
11 of variables with respect to this quality
12 estimation?

13 THE WITNESS: By all means.

14 I think it's appropriate to start
15 with the dependent variable, which is
16 essentially for everyone else here, what we're
17 trying to explain through the regression. So,
18 at the risk of getting a lot of people in the
19 audience bored, essentially, we're taking the
20 monthly price and taking the logarithm of the
21 monthly subscription price and we have an
22 observation for every one of the 30 services.

1 Then, going down the list of variables -- let
2 me back up for a second.

3 The source data in all cases was
4 compiled by my staff, using the web pages of
5 the different music services. We started by
6 doing a very broad search to try to find all
7 the services that we could and these are the
8 ones that were the subscription services
9 available at the market, at that point in
10 time. We also attempted, from our own
11 efforts, to count the number of radio
12 stations, to essentially catalogue, we
13 essentially created a database and catalogued
14 the number of radio stations, whether or not
15 it was interactive, which here is meant to be
16 on-demand or not, and the same thing with
17 respect to download and sound quality. And I
18 apologize, I don't remember what the
19 breakpoints were in sound quality, at what bit
20 rate. And it was a little hard to determine
21 that, but to the extent the services reported
22 it, we tried to capture that. So, that's the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 source data.

2 And then with respect to the
3 individual variables, there's first the
4 intercept. And the intercept simply sort of
5 roots the equation at some point, essentially
6 on the vertical axis. It's just simply a way
7 of fitting an equation. If you were to think
8 of this again for other members, other court
9 members, if you're thinking of trying to fit
10 a -- can I use a piece of paper here? Do you
11 mind?

12 JUDGE WISNIEWSKI: There's a
13 bulletin board --

14 THE WITNESS: Okay. That would be
15 fine.

16 If we were to imagine that we're
17 trying to explain something where we can
18 observe a spatter of data and the data tells
19 us something about the price and something
20 about, let's in this case, we're in two
21 dimensions, whether it's a number of radio
22 stations or whatever the explanatory variable

1 is, all the intercept does is say, let's draw
2 that line and have it hit this access there.
3 So, it's just simply telling you where to
4 start the line. And then all of these others
5 are telling you what the slope of the line is
6 with respect to that variable. So, that's the
7 intercept. It's highly significant and it's
8 just simply, that's just the nature of what
9 the data does.

10 The log of number of radio
11 stations and the square of the log of the
12 number of radio stations, we put in two
13 variables there. First we put it in logs,
14 because it would appear that this has a,
15 should have a percentage relationship between
16 number of radio stations and the price, rather
17 than that going from five to six was the same
18 as going from 200 to 201. That would -- if
19 you use a linear measure, you're going to make
20 the assumption that five to six is the same as
21 100 to 101, the logarithmic turns it into a
22 percentage relationship. So, that's the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 reason for using a log.

2 The square of the log we tried out
3 just to see if there was some nonlinearity
4 even in the logarithmic form. We tried
5 various specifications here. None of them
6 proved to be very significant. And then, we
7 have interactivity which was a zero/one
8 variable. In other words, one if it is on-
9 demand, zero if it's not. And the coefficient
10 estimate is highly significant, T value of
11 4.5, which would give you a greater than 99
12 percent confidence interval.

13 The next variable, download to
14 portable device, is also a zero/one variable,
15 zero where it's not downloaded, one where it
16 is downloadable. Coefficient 0.48 and T value
17 2.57. I don't recall where that gives you as
18 far as confidence. My guess is that it would
19 be over 95 percent, but I'm not sure where
20 exactly it lies.

21 Sound quality was, from an
22 econometric standpoint, not very helpful. In

1 fact, it's the wrong sign because it indicates
2 that as sound quality goes up, people would
3 pay less. So, it's clearly not picking up the
4 true effect of sound quality. There's only a
5 very limited variation in the sound quality in
6 the sample we chose and I attach no
7 significance to it.

8 I also had, if you'll see in the
9 note, there were some dummy variables for
10 Digital Imported service and Bell South's
11 service. Those were outliers. The Digital
12 imported price and was way up there and wasn't
13 explainable by anything else. And, in fact,
14 I think as Mr. Steinthal pointed out to me,
15 they've dropped the price. So, we tried
16 various ways to deal with this. We excluded
17 them from the regression, we put in dummies.
18 In my opinion it was an aberration in the
19 market and that's how I treated it in the
20 regression. And I think that's how the market
21 seems to be treating it.

22 And the Bell South we, again, it

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 was an odd observation. And again, we tried
2 it with Bell South in and Bell South out. We
3 tried a lot of specifications and they
4 provided the same results or, as I said, some
5 of them such as sound quality, just didn't
6 give us anything satisfactory.

7 So, I hope that answers your
8 question, Your Honor.

9 JUDGE WISNIEWSKI: The values on
10 those two dummies were high. Right?

11 THE WITNESS: Yes, they were, I
12 believe. I can go back and check.

13 JUDGE WISNIEWSKI: While you're
14 doing that, one other question on the sound
15 quality variable. How did you quantify that?
16 I'm sorry, was it a --

17 THE WITNESS: I'm sorry. We set
18 up a tier. So, we said, when we originally
19 looked at these services, we said well, let's
20 try to do something about sound quality, and
21 we set up, or my research assistant set up
22 something where he set up, the right word

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 here is, sort of groupings. So, there was
2 from, lets say zero to 28 kilobits per second
3 was low quality, 28 to 56 was medium quality,
4 above 56 was high quality. And we actually,
5 I think one of the early observations we saw,
6 a little more variation in them when we looked
7 at the sample more carefully and looked at the
8 services more carefully, we found that there
9 was only one observation that turned out to
10 have medium quality. But all the others, it
11 seems pretty natural as part of being a
12 subscription service, were providing things
13 above a certain, I think it was 56 or 64 --

14 JUDGE WISNIEWSKI: I guess the
15 question I had was what numbers did you
16 actually use?

17 THE WITNESS: I don't recall. I'd
18 be happy to provide them.

19 JUDGE WISNIEWSKI: Okay. Thank
20 you.

21 And I take it that you did other
22 alternative specifications and tried them out,

1 is what I heard you say. Is that --

2 THE WITNESS: Yes, sir.

3 JUDGE WISNIEWSKI: Is that
4 correct?

5 Did you do an alternative
6 specification that had, that was limited to
7 the variables that you found to be significant
8 here?

9 THE WITNESS: The ones I have with
10 me here right now, I don't have a regression
11 like that. I don't know whether we tried it.

12 JUDGE WISNIEWSKI: Okay. I was
13 just curious as to whether you did or how that
14 might have come up.

15 I don't think I have any further
16 questions.

17 CHIEF JUDGE SLEDGE: Any further
18 questions generated by those posed from the
19 bench?

20 MR. STEINTHAL: I have one
21 question, Your Honor.

22 CHIEF JUDGE SLEDGE: All right.

1 RECROSS-EXAMINATION

2 BY MR. STEINTHAL:

3 Q Dr. Pelcovits, do I understand
4 from what you just said that the variable as
5 to the number of stations offered by the
6 service was such that you concluded that it,
7 the number of stations offered by the service
8 was not a significant or material aspect in
9 the value proposition?

10 A That's the regression results.

11 MR. STEINTHAL: Thank you.

12 CHIEF JUDGE SLEDGE: Judge
13 Wisniewski?

14 JUDGE WISNIEWSKI: Yes, I'm sorry,
15 I did have one further question. Just as a
16 matter of cleaning up an issue.

17 I believe that you had testified
18 with respect to demand elasticity for a number
19 of these markets. I was just wondering if you
20 had done any estimates of cross-price
21 elasticity of demand?

22 THE WITNESS: I did not.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 JUDGE WISNIEWSKI: Thank you.

2 CHIEF JUDGE SLEDGE: Mr. Handzo?

3 MR. HANDZO: Nothing further.

4 CHIEF JUDGE SLEDGE: Okay. Well,
5 then that then completes our examination of
6 Dr. Pelcovits.

7 Any other matters to be addressed
8 before we recess for the day?

9 And our witness, again, in the
10 morning?

11 MR. HANDZO: I believe the
12 anticipated order is, I think, Brook Simson.

13 CHIEF JUDGE SLEDGE: Brook Vinson?

14 MR. HANDZO: Yes. I'm sorry, yes.
15 Fink. Fink Brook Vinson.

16 CHIEF JUDGE SLEDGE: Fink Brook?

17 MR. HANDZO: Yes.

18 CHIEF JUDGE SLEDGE: Thank you.
19 We'll recess until 9:30 in the morning.

20 (Whereupon, at 4:38 p.m., the
21 hearing was adjourned, to reconvene at 9:30
22 a.m., Wednesday, May 17, 2006.)

CERTIFICATE

This is to certify that the foregoing
transcript in the matter of:

The Digital Performance Right in
Sound Recording and Ephemeral
Recordings (Webcasting Rate
Adjustment Proceeding)

Before: Copyright Royalty Board

Date: Tuesday, May 16, 2006

Place: Washington, D.C.

represents the full and complete proceedings of
the aforementioned matter, as reported and
reduced to typewriting.

